INTERNATIONAL MONETARY FUND

# JOBS AND GROWTH: ANALYTICAL AND OPERATIONAL CONSIDERATIONS FOR THE FUND

March 14, 2013

## EXECUTIVE SUMMARY


Job creation and growth with inclusion are imperatives that resonate today in every country. While some advanced countries face the challenge of supporting aggregate demand with limited fiscal space in the aftermath of the Great Recession, many countries have to address ways to generate growth and create jobs in the face of the strong ongoing global megatrends of technological change, globalization, and significant shifts in demographic trends. The latter includes rapid population aging in some parts of the world, and the entry of a large number of new workers into the labor force in others. Low female labor force participation represents a significant missed opportunity to strengthen economic development and growth in many countries.

The paper discusses the role the Fund can play in helping countries devise strategies to meet these challenges by reviewing the theoretical and empirical state of the art in relevant policy research so as to provide the best "evidence based" advice. The main finding is that there is no single "silver bullet" strategy for any country nor any "one size fits all" approach for all countries That said, one element of the approach on which there is little disagreement is the critical importance of macroeconomic stability—low inflation and output volatility—as the essential foundation for any growth strategy.

A review of Fund country and policy work yields the conclusion that, although there has been an increasing amount of coverage of issues related to growth and inclusion, there is scope to improve the analysis and policy advice, where relevant and consistent with the Fund's mandate. Specifically, there is scope for:

- More systematic diagnostic analysis of the growth and employment challenges and the identification of the most binding constraints to inclusive growth and jobs so as to provide more tailored and relevant policy advice.
- More systematic integration of policy advice on reforms of tax and expenditure policy to create conditions to encourage more labor force participation, including by women; more robust job creation; more equity in income distribution; and greater protection for the most vulnerable.
- Enhance advice on labor market policies based on currently available empirical evidence and greater collaboration with international institutions such as the World Bank, the OECD, and the ILO on the impact of these policies on growth, productivity, job creation, and inclusion.

Approved By
**Olivier Blanchard, Carlo Cottarelli, and Siddharth Tiwari**

Prepared by a staff team supervised by Kalpana Kochhar (SPR), Prakash Loungani (RES), Ranil Salgado (SPR), and Ben Clements (FAD); coordinated by Hans Weisfeld (SPR); and comprising: Rabah Arezki, Mai Dao, Davide Furceri, Florence Jaumotte, Hites Ahir, and Saurabh Mishra (all RES); Katrin Elborgh-Woytek, Lars Engstrom, Monique Newiak, Jarkko Turunen, Cristina Constantinescu, and Emmanuel Hife (all SPR); and Baoping Shang (FAD). Other contributors were Ruo Chen, Era Dabla-Norris, Sarwat Jahan, and Chris Papageorgiou (all SPR); Stefania Fabrizio and Masahiro Nozaki (FAD); Dalia Hakura and Nikola Spatafora (both ICD); Chanda DeLong, Damien Eastman, Hoang Pham, and Nadia Rendak (all LEG); and Mick Silver and Kimberly Zieschang (both STA). Editorial assistance was provided by Pille Snydstrup and Sean Carter (both SPR).

## CONTENTS

## BOXES



## FIGURES



## TABLES



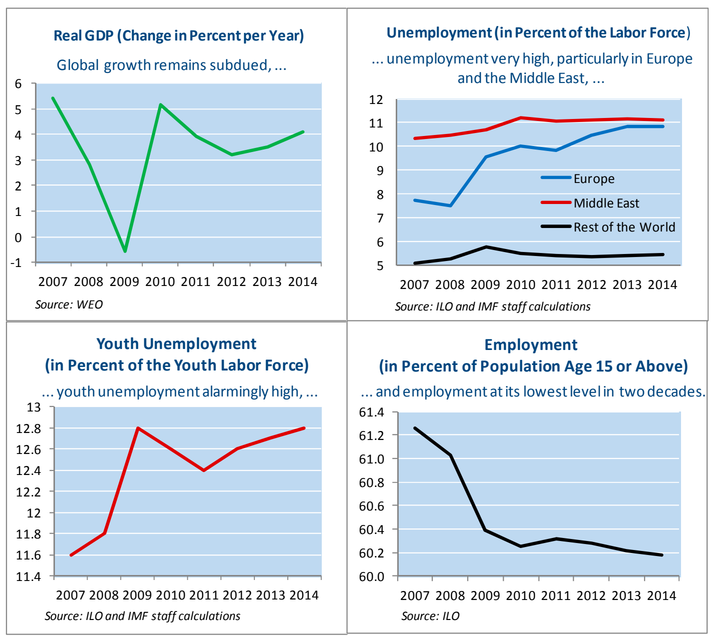
## ANNEXES

# I. INTRODUCTION

1. **Job creation and inclusive growth are imperatives that resonate today in every country in the world**—be it small, large, advanced, emerging, developing, post-conflict, or resource rich. For those countries at the epicenter of the global financial crisis, the objective is front and center and urgent as they focus on the large numbers of people who lost their jobs during the Great Recession. For other countries, which are further removed from the epicenter of the crisis, the jobs imperative arises from the need to foster structural transformation and accommodate the large numbers of new entrants into the labor markets so as to reap the demographic dividend.[1] For yet others, the objective is to find ways of enhancing labor force participation and productivity in the face of aging populations.

2. **At the same time that jobs are the number one priority, the outlook for growth and jobs remains a major concern** (Figure 1). Following very weak growth since 2009, world growth is projected to be only around 3½ percent this year, about 2 percentage points below the pre-Great Recession years (IMF, 2012a). Over 200 million people across the world are unemployed, with youth and long-term unemployment at alarming levels in many countries. Globally, the employment rate (the employment to population ratio) remains at 60 percent—its lowest level in two decades—and unemployment is projected to remain elevated for several years (International Institute for Labour Studies, World of Work, 2012). Despite some recent narrowing of the gender gap, the average female Labor Force Participation Rate (LFPR) remains low at around 50 percent (World Bank 2011; OECD 2012; Annex 1). Income inequality has increased in past decades in many Organisation for Economic Cooperation and Development (OECD) countries (OECD, Going for Growth, 2012) and is also on the rise in many

**Figure 1. Developments in World Employment and Growth, 2007-2014**




[1] When countries go through phases where the number of workers are growing more rapidly than the number of dependents, the resources saved from having fewer dependents can provide a "demographic dividend," which can be reaped through the creation of jobs to absorb the new labor force entrants.

others. Across OECD countries, the gender wage gap is estimated at 16 percent (OECD 2012). Although we are on track to meet the Millennium Development Goal (MDG) of halving the proportion of people living in extreme poverty (on less than $1 a day) by 2015 relative to 1990 levels, over 900 million people are expected to remain vulnerable to being pushed back into poverty in the face of adverse shocks (UN, World Economic Situation and Prospects, 2013).

3. **In addition to the current conjuncture of weak aggregate demand, there are global megatrends that are influencing developments in jobs and growth**. Globalization (the process by which countries open up to trade and financial flows) and technological change, along with the doubling of the global work force as China, India, and the transition economies opened up in the 1980s and 1990s, have undoubtedly helped raise overall global growth and welfare, but have also posed many challenges. For advanced countries, it has meant reduced demand for lower skilled workers in part because of outsourcing of both manufacturing and service sector jobs, and growth models in some of these countries relied, for example, on the construction sector for jobs for these workers and/or on excessive financial sector deregulation. The challenge for these countries is to find new sources of growth, as earlier models proved unsustainable. For developing countries, the need is to continue to enable structural transformation and catch up while addressing challenges ranging from employing large numbers of young people entering the labor force to upgrading skills and innovation to avoid the middle income trap.

4. **Faced with these challenges, many governments have set for themselves the goal of "inclusive growth"—growth where the benefits are widely shared across the population—and have realized that enabling strong employment growth is an essential part of the strategy to achieve that goal**. Against this backdrop, this paper discusses the role the Fund can play in helping countries meet their aspirations for stronger and more inclusive growth and job creation. It compares the Fund's work in these areas against the prevailing state of evidence and knowledge and—on the basis of the gaps identified through this process—makes recommendations on how this work could be enhanced, while remaining consistent with the Fund's mandate.

5. **The challenges of growth, job creation, and inclusion are closely linked**. The consensus among economists is that growth is an essential prerequisite (but not always sufficient) for job creation and social cohesion. In turn, jobs and increased labor force participation, including among women, are important to foster inclusive growth and reduce poverty and income inequality; and social cohesion and job creation can lead to more sustained growth. It bears reiterating that at the heart of this nexus lies productivity growth—those economies with the highest growth in per capita incomes are also those that have experienced the highest growth in labor productivity by investing in physical and human capital and embracing technological change. That said, there is no one answer for how best to promote growth, jobs, and inclusion as the challenges vary across countries and there are limits to the existing knowledge of what drives growth more generally. This paper attempts to provide guidance and options for how the Fund can advise its member countries on these issues.

6. **The main recommendations of the paper are that Fund work could provide more systematic diagnosis of the determinants of growth, job creation, and income distribution—when consistent with the Fund's mandate—and could help members better understand the effectiveness of their policies to support growth, employment, and inclusion**. Such a diagnostic assessment could help countries identify policy choices that may both enhance growth and make income distribution more equal, as well as more clearly identify trade-offs. This would enable greater tailoring of policy recommendations to countries' preferences and constraints. A salutary side effect is that this approach could help enhance the traction of Fund's policy advice. The Fund's role on these issues should be guided by its mandate, in particular that issues of growth, job creation, and income distribution need to be considered to the extent that they have a bearing on domestic and balance of payments stability. In addition, the Fund should take account of members' objectives in the areas of growth, employment, and income distribution in its advice on the promotion of stability, and may provide advice specifically in these areas if a member country requests it.[2]

7. **While the paper provides an initial framework for the Fund's role on jobs and growth, further work will be needed in these areas to sharpen policy analysis and recommendations.** In particular, there are many issues that have not been tackled in this paper. Two important ones are the role of labor migration in the strategies for growth and inclusion in countries on both sides of the demographic transition; and policies to reduce the wedge between formal and informal labor markets in many developing countries with a view to increasing productive employment and reducing workers' vulnerability to falling back into poverty. Other topics that could be examined in the future include the effects of public sector employment opportunities on women's labor force participation and as countercyclical tools to protect employment and further analysis on the determinants and design of successful labor market institutions which balance the protection of workers with flexibility of resource reallocation. Some of this work could be done jointly with institutions like the World Bank, the OECD, and the International Labour Organization (ILO).

8. **The rest of the paper is organized as follows**: Section II describes the broad forces that influence growth, job creation, and income distribution in advanced and developing countries and the resulting challenges and policy priorities. Sections III, IV and V review existing knowledge on growth, jobs, and inclusive growth, respectively. Section VI conducts a stock-taking of the way in which growth, job creation, and inclusion have been addressed in Fund surveillance and incorporated in Fund-supported programs in recent years. And finally, section VII makes recommendations to enhance the Fund's work on these topics.

[2] Section VI (below) has more information on the Fund's role on these issues.

# II. MEGATRENDS SHAPING DEVELOPMENTS IN JOBS AND GROWTH

9. **Three sets of forces have had a large impact on growth and job creation in advanced and developing countries in recent decades**.

- *Technological innovation, globalization, and the growing global labor force*: Technological change and trade, which have occurred through much of history, have had an overwhelmingly positive impact on world income and overall welfare. The impact on within-country income distribution, however, has varied over time. In the decades following World War II, for example, productivity growth and growing trade co-existed with increasing equality in income distribution in advanced countries. Over recent decades, these broad forces—including importantly financial globalization—along with the doubling of the global work force as China, India, and transition economies moved to more market-based economies and opened up to the global economy in the 1980s and 1990s, led to momentous changes (Figure 2). Many emerging markets experienced rapid growth, and millions of people in these countries were able to emerge out of poverty, with inequality measured at the global level (or assuming the world is one country) declining, reflecting large income gains in developing countries. Advanced countries, too, reaped substantial benefits, for example, in the form of real income gains thanks to lower prices. But at the same time, it has meant reduced demand for lower-skilled workers in advanced economies and some emerging markets, particularly in manufacturing, and more recently in services—now the fastest-growing component of global trade.[3] As a result, while inequality fell on a global scale, within-country inequality rose, especially in almost all advanced countries.[4] Annex 2 reviews the influence of technological change and globalization on inequality in countries at different income levels over recent decades. The analysis presented in the box shows that the increase in within-country inequality reflects changes in technology and, to a lesser extent, changes in financial globalization.[5] These have been offset by improved education and changes in the sectoral composition of employment. Trade liberalization and export growth are associated with lower income inequality, especially in developing countries. These findings of course do not imply that technological progress should be stopped or globalization reversed. These two trends are sources of long-run gains in prosperity. But understanding their distributional effects, and the channels through which they occur, can help devise policy measures that mitigate adverse effects and allow the prosperity to be shared more broadly. For instance, some of the negative effects of financial globalization could be alleviated by ensuring that any liberalization is well-planned, timed, and sequenced so as to give time for appropriate paced development of financial institutions and markets.

---

[3] Developing countries are now exporting not only traditional services (such as transportation and tourism) but also computer and information services, legal and technical support, and other business services. India was the pioneer in this field but Brazil, Chile, China, Malaysia, the Philippines, and other countries are also competing in this sector, reflecting a more general trend of increased movement of jobs across countries.

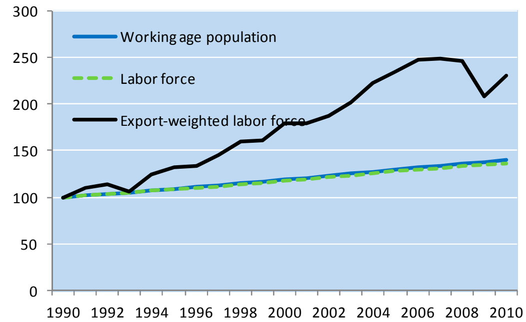
[4] Global inequality is calculated by combining the individual income distributions of 138 countries. The means of the individual country distributions are the population-weighted levels of GDP per capita taken from the Penn World Tables, while the dispersion around the means is estimated using micro survey data (for a small share of countries, the distribution around the mean is imputed using survey data from other countries). Based on this world income distribution, the Gini coefficient is calculated as if the world was one country.

[5] Hoeller et al., 2012 showed that most of the inequality in OECD countries was driven by inequality of labor or wage income (rather than labor income versus capital income).

## Figure 2. Megatrends and Their Impacts

**Global Labor Supply**
**(Index 1990 = 100)**

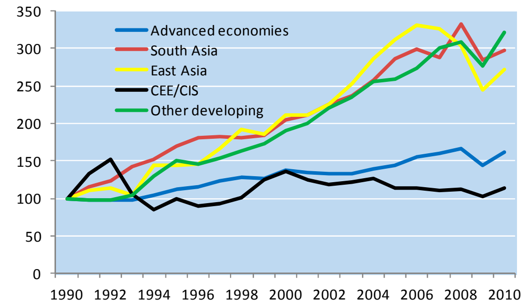
The effective global labor force has more than doubled since 1990...




*Methodology as in IMF (2007), Chapter 5.*

**Exports-Weighted Labor Force by Economic Group/Region**
**(Index 1990 = 100)**

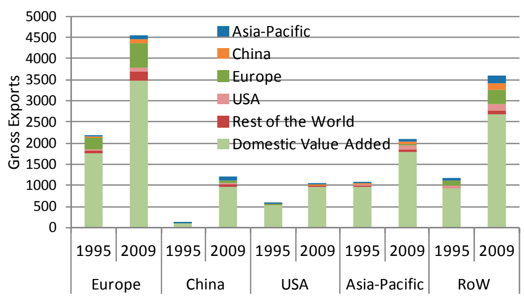
...with high population growth and rising trade openness in Asia contributing more than half of the increase.




*Methodology as in IMF (2007), Chapter 5.*

**Value Added Content of Exports, 1995 and 2009**
**(In Billions of U.S. Dollars)**

Global supply chains have gained in importance, reflecting among other things the growing integration of emerging markets into the global economy.




*Source: World Input-Output Database (WIOD), WEO, Fund staff estimates.*
Note: Europe(AUT,BEL,DEU,EST,FIN,FRA,IRL,LUX,NLD,SVK,SVN,CYP,ESP, GRC,ITA,MLT,PRT,BGR,CZE,DNK,GBR,HUN,LTU,LVA,POL,ROM,SWE), Asia-Pacific(AUS,CAN,IDN,IND,JPN,KOR,MEX,TWN), ROW (BRA,RUS,TUR,ROW).

**Top Manufacturing Countries, 1980 and 2010**

Thanks in part to this integration, emerging markets have moved up the ranks of the largest manufacturing nations worldwide.

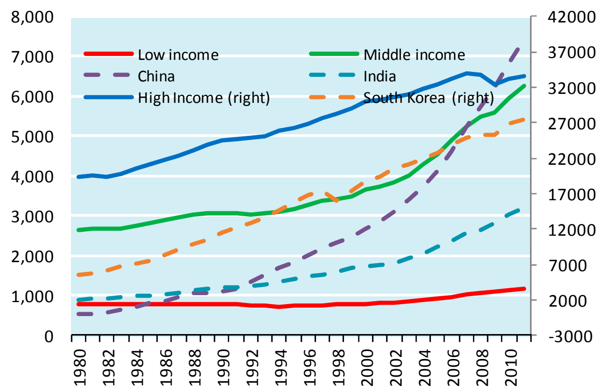
| Rank | 1980 | 2010 |
|---|---|---|
| 1 | US | US |
| 2 | Germany | China |
| 3 | Japan | Japan |
| 4 | UK | Germany |
| 5 | France | Italy |
| 6 | Italy | Brazil |
| 7 | China | South Korea |
| 8 | Brazil | France |
| 9 | Spain | UK |
| 10 | Canada | India |
| 11 | Mexico | Russia |
| 12 | Australia | Mexico |
| 13 | Netherlands | Indonesia |
| 14 | Argentina | Spain |
| 15 | India | Canada |

*Source: IHS Global Insight, McKinsey Global Institute*

## Figure 2. Megatrends and Their Impacts (cont.'d)

### GDP per Capita (PPP) in Constant 2005 U.S. Dollars.

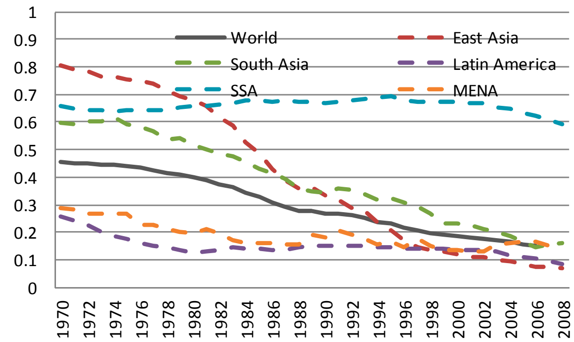
In the process, income in a number of emerging market countries, especially in Asia, has risen sharply.




*Source: World Bank*

### Poverty Rates by Region, 1970-2008[1]

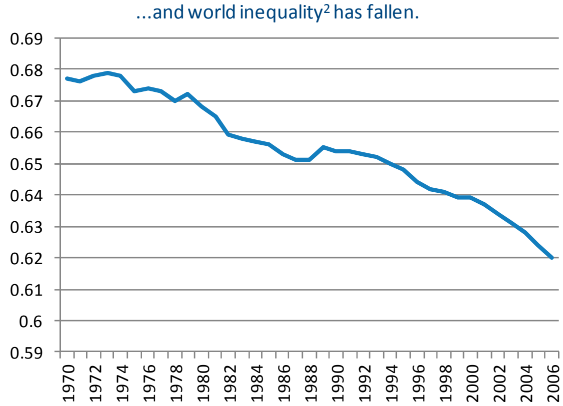
As a result, millions of people were able to escape poverty...




*[1]Poverty rate is defined as the fraction of the population living for less than $2 per day. Source: Sala-i-Martin (2006) and staff estimates (2008) based on World Development Indicators (2013).*

### World Gini Coefficient, 1970 - 2006

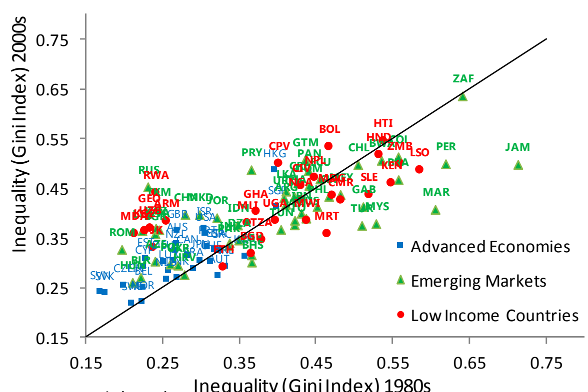
...and world inequality[2] has fallen.



*[2]World inequality is defined by the Gini Index, assuming the world is one country. Source: Sala-i-Martin (2006).*

### Income Inequality in the 1980s and 2000s

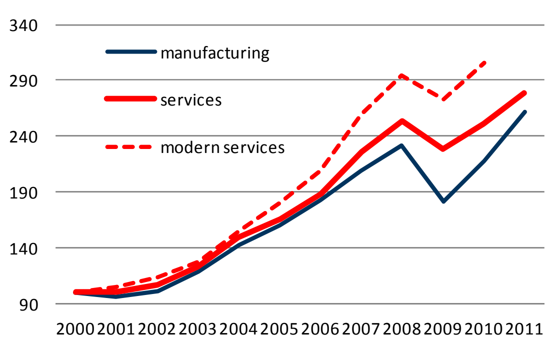
Nevertheless, within-country inequality has risen in the majority of countries, particularly in advanced ones.




*Source: Solt (2009)*

### Manufactured Goods and Services Exports, 2000-2011 (Index, 2000=100)

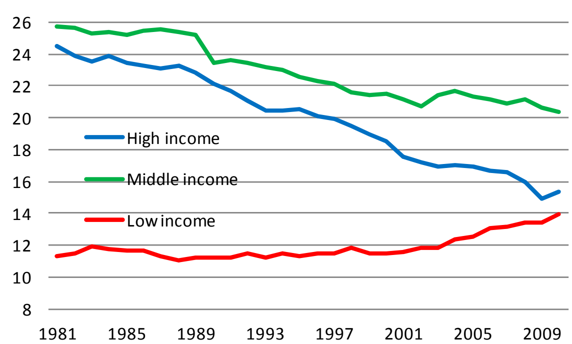
Services, particularly "modern" services, account for an ever-increasing share of exports and GDP, ...




*Source: IMF. Note: Modern services comprise financial services, computer and information services; royalties and license fees; and other business services.*

### Manufacturing Value Added as Share of GDP, 1981-2009

... with the share of manufacturing in GDP falling in high- and middle-income countries.




*Source: World Bank*

- Demographic trends: The situation has been further complicated by shifts in demographic trends across different countries. In many developing countries, particularly in East Asia, South Asia, the Middle East, and Africa, the recent period during which the number of workers has been growing more rapidly than the number of dependents was able to provide a tailwind in support of policy reform, as the resources saved from having fewer dependents provided a "demographic dividend" (Figure 3). This dividend can be reaped only if a policy framework is in place to channel the savings into high priority physical and human capital investments necessary to absorb the growing number of entrants into the labor force at rising wages and more productive employment. By contrast, populations in most advanced countries are aging. This has implications for how the labor force responds to changes in demands for certain skills, for the room for investment as the economy enters the phase where savings are drawn down, and for the strains on public budgets in the form of growing pension and health care costs.

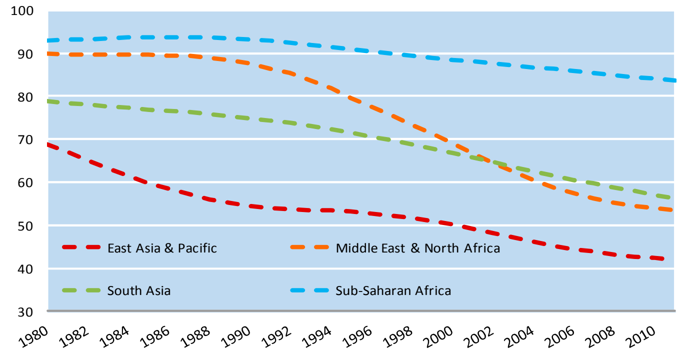
- *Global Recession*: The Great Recession of 2008/09 was one of the deepest and most synchronized recessions in advanced countries during the past 50 years (Kose, Loungani, Terrones, 2013). In many, output remains far below potential and unemployment high, as simultaneous efforts by households, banks, and governments to deleverage are depressing aggregate demand. The resulting high unemployment is further exacerbating income inequality. During the initial years of the recession, gender employment gaps shrank in most OECD countries, mainly due to more robust employment in the services sector, compared to male-dominated sectors such as construction and manufacturing. However, the pattern changed between 2009 and 2012, when female employment continued to rise, while unemployment among men either declined or slowed down. The recession also reduced fiscal space in advanced countries, due to higher demands on expenditure to support troubled banking systems and to sharply lower revenues as activity collapsed. By implication, in some of these countries, the scope for governments to step in and pick up the slack in aggregate demand is limited.

10. **Confronted with these megatrends, countries at different income levels are facing different challenges and different policy priorities**.

- *Advanced countries*: The most urgent priority in many advanced countries is to reduce the massive unemployment arising in the aftermath of the global financial crisis. Policies need to focus on boosting aggregate demand (within available fiscal and financial space) to rekindle growth and close the output gap. Measures to boost aggregate demand need to be supported by reforms to remove structural bottlenecks to productivity growth so as to enable these countries to draw the largest possible advantages from the ongoing megatrends, while mitigating the impact on more vulnerable portions of their populations, improving income distribution, and addressing labor market segregation along gender lines. New sources of growth may also be needed in some of these countries, as earlier models based on financial services and construction have proved unsustainable.

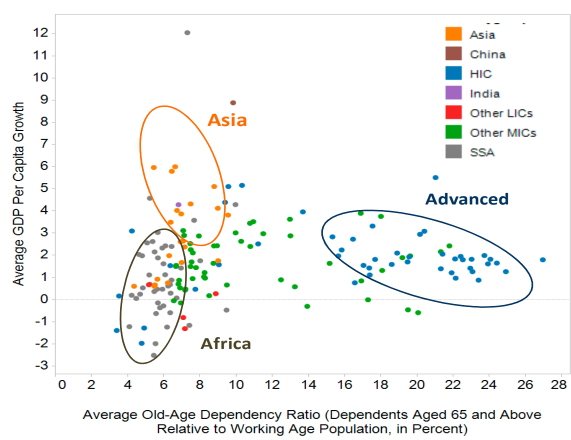
## Figure 3. Demographic Trends in Recent Decades

**Age Dependency Ratios for Selected Regions, 1980-2011**
**(Percent of Population Aged under 15 or above 64 relative to working age population)**
Age Dependency Ratios have fallen significantly in several regions, providing a tailwind in support of policy reform.



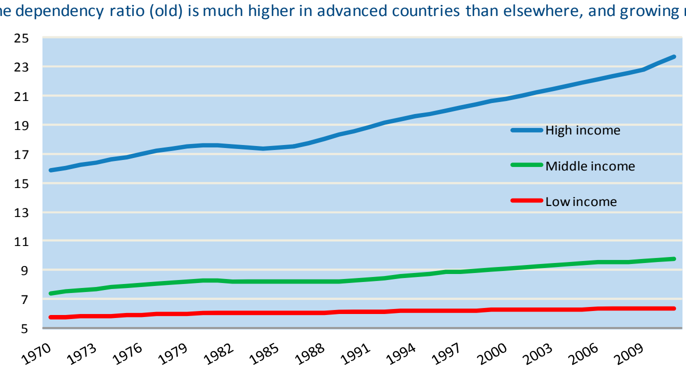

*Source: World Development Indicators, 2013.*

**Old Age Dependency Ratio and Per-Capita GDP Growth, 1980-2012**
Many Asian countries combined young populations with growth-friendly policies. As a result, they benefited from "the demographic dividend" in the form of robust growth in per-capita GDP. Countries with older populations or with less favorable policies tended to grow by less.




*Source: World Development Indicators (2013) and Fund staff estimates.*

**Old Age Dependency Ratio, 1970-2011 (Ratio of population aged 65 and above relative to working-age population, in percent)**
The dependency ratio (old) is much higher in advanced countries than elsewhere, and growing rapidly.




*Source: World Development Indicators (2013)*

- *Developing countries*: Many dynamic emerging markets and developing countries have already drawn large benefits from integrating into the world economy and from the absorption of new technologies. But many still face the challenge of catching up to advanced countries, a process that involves structural transformation, including both faster rates of factor accumulation and growth in total factor productivity. Many developing countries also face high and, in some cases, growing inequality. In rapidly growing countries, this may reflect rapid structural change, in line with Kuznets' theory of rising inequality in earlier stages of development.[6] In others, high inequality may instead reflect a lack of economic and political inclusion and market imperfections that allow a small elite to capture large rents. Redistribution, including by removing privileges that lead to capture by a few, are likely important prerequisites for accelerating growth.[7] Finally, a number of developing countries face particular challenges, e.g., how to reap the benefits and avoid the pitfalls of large resource endowments, or how to generate private sector led growth in fragile, post conflict environments.

11. **Looking ahead, technological innovation is set to continue and the global labor force to keep growing**. While there is some discussion whether the pace of technological innovation has slowed,[8] there can be little doubt that innovation will continue, raising global welfare but likely also continuing to increase the relative demand for higher skills, thereby possibly further exacerbating inequality in income. This effect is likely to be more pronounced in advanced countries, where the use of technology is widespread in both manufacturing and services, affecting a substantial segment of the economy. The global labor force is also set to continue growing, albeit at a reduced pace as East Asia's economies mature. Most of the growth in the labor force will be driven by non-Asian developing countries whose export-weighted working-age population is expected to surpass that of East Asia by 2040 (Figure 4).

12. **Accordingly, the opportunities awarded and the challenges posed by these trends will likely persist**. Some analysts have argued that outsourcing by advanced countries may be slowing, particularly in the United States.[9] While it is too early to assess this claim, even if some manufacturing were to return to advanced countries, this is unlikely to result in a proportional increase in employment. This is because most returning manufacturing is likely to be highly skilled and capital intensive, while unskilled labor is increasingly replaced by technological improvements such as robotics. This means that while returning manufacturing may help boost growth, it may not be as helpful in creating jobs and reducing inequality.

---

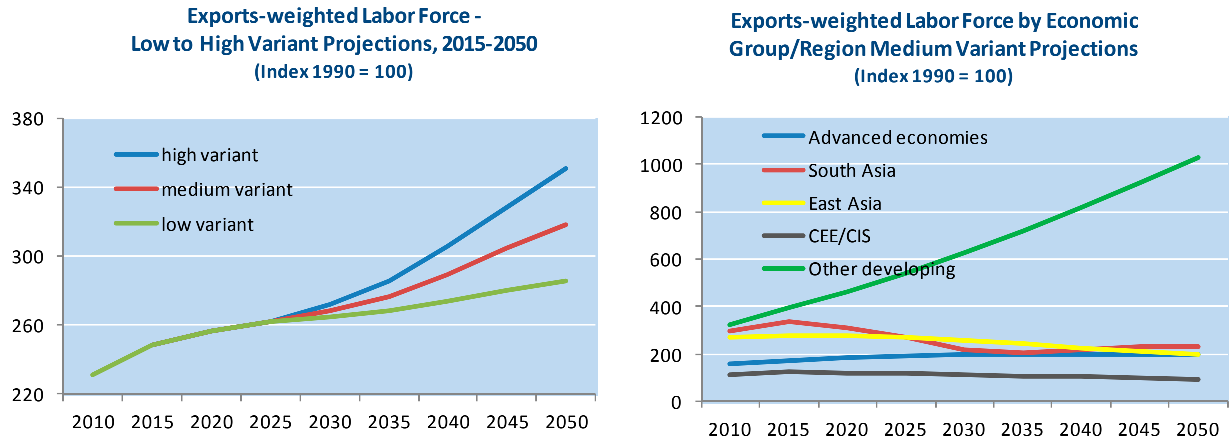
[6] At early stages of development or industrialization, Kuznets hypothesized that inequality rises as workers shift from agriculture to industry creating a rural-urban income gap while also suppressing worker wages in cities to the benefit of owners of capital, due to the influx of rural labor. After countries reach a certain level of average income, however, inequality begins to decline as potential excess rural labor is exhausted.

[7] This could also be applicable in some advanced economies.

[8] *The Economist* of January 12, 2013 and references therein.

[9] See, for example, *Financial Times*, September 21, 2012; *New York Times*, November 25, 2012; and *The Atlantic, November* 2012 *The Economist* of January 12, 2013 and references therein.

**Figure 4. Global Labor Force, 2010-2050**




*Projections are based on the low, medium and high variants of the UN working-age population projections, assumptions of converging participation rates, and country-specific WEO projections for export to GDP growth until 2017 (and extrapolating world trends thereafter).*

*Projections are based on the medium variant of the UN working-age population projections, assumptions of converging participation rates, and country-specific WEO projections for export to GDP growth until 2017 (and extrapolating world trends thereafter).*

# III. GROWTH: ISSUES AND STRATEGIES

13. **This section focuses on the current state of evidence and knowledge on the policy approaches that are conducive to sustained and rapid growth**. For the majority of Fund members, the challenge is still one of catch-up to the income levels of advanced economies and the associated structural transformation.

## A. Developing Countries

14. **Much of the conventional wisdom on how countries can catch up is summarized in the report and background work conducted between 2006 and 2009 by the Commission on Growth and Development led by Nobel Laureate Michael Spence** (hereafter, the Growth Commission). The Growth Commission noted that since 1950, 13 economies grew by an average rate of 7 percent or more for at least 25 years in a row, "but we cannot name with certainty the factors that sealed their success, or the factors they could have succeeded without. It would be preferable if it were otherwise." That said, some common characteristics of economies that enjoyed sustained growth were: (i) openness to the global economy; (ii) macroeconomic stability; (iii) high rates of private and public investment (including on infrastructure), matched by domestic savings; (iv) respect for market signals but not absolute deference to markets; and (v) governments committed to trying out country-specific growth strategies and abandoning policies that are no longer useful; and (vi) government provision of public goods. The Commission noted that this list of characteristics "does not provide a formula for policy makers to apply—no generic formula exists. Each country has specific characteristics and historical experiences that must be reflected in its growth strategy" (see Annex 3 for a detailed discussion of "What Works, What Doesn't").

15. **Both the Growth Commission report and World Bank's World Development Report on Jobs (hereafter, WDR 2013) stress the importance of diversification and structural transformation as an essential part of the process of catch up**. Economic development ultimately involves structural transformation, that is, a reallocation of resources from less productive to more productive sectors and activities. McMillan and Rodrik (2011) argue that labor flows from low-productivity activities to high-productivity activities are a key driver of development. In many developing countries and even some emerging markets, this needs to occur through more rapid reallocation of labor from agriculture to industry and services, where TFP growth is higher. Reallocation across sectors needs to be complemented by the movement of labor out of lower-productivity firms in manufacturing and services into higher-productivity firms within those sectors. Since 1990, the bulk of the difference between the productivity performance of Latin America and Africa, on the one hand, and Asia, on the other, is accounted for by differences in the pattern of structural change. Labor has moved from low- to high-productivity sectors in Asia, but in the opposite direction in Latin America and Africa. Reallocation both across and within sectors will require significant physical capital accumulation (in basic infrastructure such as power and transport), investment in human capital, equal access to education and health services to provide workers with the skills necessary to access better jobs and transition from the informal to formal sector. A higher female labor force participation rate, supported by targeted labor market policies, could make a significant contribution to growth in many countries. Another driver of rapid growth in developing countries is diversification. Imbs and Wacziarg (2003) document that higher incomes per capita are associated first with diversification, and then with reconcentration, in production and employment. Diversification in exports is also increasingly touted as a channel for catch-up.

16. **Some commentators have advocated exchange rate undervaluation as part of a growth strategy**. There is ample empirical evidence that prolonged over-valuation of the exchange rate hurts growth and employment, in particular if it goes hand in hand with the resource curse/Dutch disease phenomena (see e.g., Johnson et al., 2007; and Rajan and Subramanian, 2008). An overvalued real exchange rate erodes a country's external competitiveness, and could lead to an unsustainable current account deficit and an eventual disruptive correction. There is also the view, advocated prominently by Rodrik (2008), that not only is over-valuation bad, but that under-valuation is good for growth, evoking for example the East Asian growth experience up until the 1990s. Also, McMillan and Rodrik (2011) suggest that competitive or undervalued exchange rates and the ability to reallocate labor across sectors help in facilitating the shift to higher-productivity and thus have contributed to growth-enhancing structural change. An under-valued exchange rate (beyond macroeconomic fundamentals) is theoretically welfare-enhancing if the tradable sector generates positive externalities such as learning and technology diffusion for the rest of the economy. However, empirical evidence for the growth effect of undervaluation as well as its channels has been far from established (see e.g., Montiel and Serven, 2008). Moreover, in practice, persistent undervaluation is problematic as it might conflict with other goals, such as low and stable inflation, and thus jeopardize growth in the medium run. Finally, even if feasible, undervaluation generates "beggar thy neighbor" effects and hence is undesirable from a global welfare perspective and thus unsustainable in the long run. Exchange rate manipulation to gain unfair competitive

advantage would not be in the spirit of global cooperation and would be inconsistent with a Fund member's obligations under the Articles of Agreement.

17. **The "growth diagnostics" approach of Hausmann, Rodrik, and Velasco suggests some practical approaches to assessing the growth performance of a country and then devising a strategy and policy priorities to improve it**. They recommend that countries "need to figure out the one or two most binding constraints on their economies" and that a focus on lifting those is preferable to having a "laundry list of needed reforms," many of which may not be "crucial to [the] country's growth potential" (Hausmann, Rodrik, and Velasco, 2006). They propose a decision tree methodology to help identify the short-run binding constraints for each country, the removal of which can be expected to ignite growth. For example, in developing countries, the most binding constraints could include adequate financing for private sector activity, weak institutions of governance, and insufficient human capital and infrastructure. In more advanced countries, the binding constraints could be shortages in the requisite skills and policies that hamper the structural transformation to more productive activities. The "growth diagnostics" approach has been applied to numerous other countries (by government agencies, multilateral agencies, and independent scholars) and is becoming a basis for donor funding in some instances.

18. **In developing countries, several specific characteristics may need to be recognized as offering special challenges in generating and sustaining high growth**.[10] For example, for many low-income countries, despite a very encouraging decade of growth, the challenge is still to make agriculture and other primary activities more productive and to facilitate the transition out of agriculture. Countries rich in natural resource endowments have tended to suffer from the "resource curse" by which rent seeking elites and vested interests misappropriate funds that can be used for the benefit of the whole population. Furthermore, these countries have to find ways to overcome the effects of "Dutch disease" whereby the ready source of foreign-exchange can lead to an exchange rate level that works against diversification. Small states have little scope to diversify their economies, which leaves them vulnerable to economic shocks, and they have a high per capita cost of government and public services. Post-conflict states have to cope with the problems of insufficient investments in human and physical capital as well as the continuing impact of a fragile security environment on economic activity. And finally, many economies often struggle to maintain their growth momentum once they hit middle income (falling into the so-called "middle income trap"). As wages rise, they lose their comparative advantage in labor-intensive industries and have to devise a growth strategy based more on innovation and a deeper stock of physical and human capital.

[10] See also Commission of Growth and Development (2008).

## B. Advanced Countries

19. **Beyond the near-term challenge of supporting and boosting aggregate demand in the aftermath of the Great Recession, advanced countries need to address longer-term issues**. The OECD's Going for Growth 2012 report and the joint ILO-IMF-OECD-World Bank report to the G-20 discuss the necessary modifications to advanced country structural reform strategies.

- The reports indicate that many advanced countries are now at a stage in their structural transformation where labor is increasingly reallocated from high-productivity manufacturing to lower-productivity services. Hence overcoming barriers to increased productivity growth in services is one of the key structural challenges facing advanced economies.

- The reports further note that the benefits of structural reforms—which in the advanced countries are typically aimed at increasing labor productivity or employment—often take time to materialize. Some structural reforms could have adverse short-term effects but these can be countered through other policy actions. For example, it appears plausible that in an environment of depressed aggregate demand, certain labor market reforms (such as reductions in unemployment benefits and employment protection) could temporarily have a negative impact on growth. The structural reform agenda should therefore be mindful of the conjunctural situation and try to counter any adverse short-term effects through other policy actions.

- Focusing on Europe, Barkbu et al. (2012) find that there is empirical evidence that structural reforms can have a significant positive impact on growth and further that positive spillovers from reforms across European countries can be significant. Structural reforms to enhance competitiveness gains in Southern Euro Area countries where demand is weak are needed to rebalance growth within the monetary union. Restoring the health of the financial sector is also critical, including through reforms to strengthen the architecture for pan-European regulation and supervision.

- Many advanced countries also face challenges to long-term growth stemming from population ageing that need to be addressed through structural reforms that gradually increase labor supply and ensure adequate buffers to counter future increases in health and pension related expenditures. Growth-enhancing labor market policies include measures to increase female labor force participation, for example, through access-to-work policies, such as non-discrimination policies and flexible work arrangements, improved parental leave benefits, and better access to comprehensive, affordable child care (Steinberg and Nakane, 2012).

# IV. JOBS: ISSUES AND STRATEGIES

20. **With over 200 million people unemployed globally and youth and long-term unemployment very high in many countries, urgent actions are needed to improve the demand for labor**, including through continued efforts to support aggregate demand, short-term interventions to enhance the functioning of the labor market (e.g., job placement assistance and retraining), and longer-term structural reforms that foster both job growth and productivity. As noted in WDR 2013, "jobs are instrumental to achieving economic and social development … they lie

at the heart of many broader societal objectives such as poverty reduction, economy-wide productivity growth, and social cohesion." Annex 4 summarizes the report's main findings and recommendations.[11]

21. **On the question of whether there is a need for a jobs strategy over and above a growth strategy, WDR 2013 notes that it is "conventional wisdom to focus on growth as a precondition" for employment growth and social cohesion**. This can indeed be the case, as shown for instance by the "remarkable experience of East Asian economies" (WDR 2013, p. 87). A more recent example is Bangladesh, where engagement with world markets through light manufacturing led to economic growth accompanied by wage employment for rural migrants and for women, cushioning social tensions. Since growth-oriented policies need to foster the process of creation and destruction while protecting people who are adversely affected by these changes, there is now a growing consensus that policies should aim to "protect workers, not jobs" (see Box 1). In line with this, a recent Fund staff study of the effects of labor market policies in advanced countries (Blanchard, Jaumotte, and Loungani, 2013) posits that well-functioning labor markets display both micro flexibility (they allow for the continuous reallocation of workers to jobs needed to sustain growth) and macro flexibility (they allow the economy to adjust to macroeconomic shocks). The need for macro and micro flexibility applies to all countries and should be a key objective of labor market policies. Examples of institutions and policies that affect micro-flexibility are unemployment insurance and employment protection, and those that affect macro-flexibility are minimum wages, tax wedges, and the structure of collective bargaining. Of course, achieving such flexibility while protecting workers is not simple and the design of labor market institutions faces delicate tradeoffs.

22. **There can also be circumstances where a "jobs strategy" may be needed to complement a growth strategy**. First, there may be long lags between growth and the creation of sufficient number of jobs, or the relationship between growth and job creation—commonly referred to as Okun's Law—may be unstable. This does not mean that the growth strategy should be abandoned, but complementary policies may be required in the near-term to sustain employment and social cohesion. Second, a jobs strategy may be appropriate when jobs confer some social benefit that are not reflected in output or may, at least in the near term, outweigh the benefits from increased output. For instance, "measured output does not increase when jobs defuse social tensions, even though these outcomes are valued by society" (WDR 2013, p. 89). Similarly, strategies may be needed to create jobs that are identified as having high development payoffs for a particular country, which could be increasing female labor participation in some cases (Annex 1), or creating employment opportunities for youth or jobs connected to global supply chains in others. Another example is Germany's practice of job sharing or "Kurzarbeit," where the government subsidizes employers to keep workers on their payrolls by reducing their working hours and their wages. Such a scheme is beneficial to workers who can remain on the job albeit at reduced pay and to employers who face a lower cost in terms of rehiring laid-off workers.

[11] While WDR 2013 is concerned mainly with developing countries, these statements also apply to advanced countries to a substantial degree.

23. **The vast majority of jobs are created in the private sector and government can help private sector job creation in three ways** (WDR 2013):

- They can provide the "*fundamentals*" for job creation: macroeconomic stability; an enabling business environment (including appropriate tax and spending policies that support job creation); human capital; rule of law; and respect for rights.

- They can ensure that *labor policies* "do not undermine job creation and instead enhance the development payoffs from jobs." The importance of labor policies should not be over-emphasized, however, since job creation is determined by many policies (including policies that provide macroeconomic stability). The report found, on the basis of an extensive study of the literature that the efficiency effects of labor policies are modest: hence policies should attempt to stay on the "plateau" and avoid the "cliffs" of either excessive regulations or extreme disregard for labor conditions. The former "clogs the creation of cities and global value chains," thus undermining the development payoffs from agglomeration and global integration. The latter—not providing mechanisms for voice and protection for even the most vulnerable workers—leads to "low living standards and a social cohesion deficit."

- They can set *priorities* by first trying to understand "where good jobs for development lie, given the country context" and then identify "selected policy interventions" that might lift the barriers to private sector creation of those jobs and reduce barriers to female employment.

24. **A key element of a jobs strategy is to put in place tax and social benefits structures that support employment**. Taxation and spending affect employment by influencing labor demand by firms and labor supply decisions by individuals. Empirical estimates suggest considerable responsiveness of workers and firms to these incentives in advanced countries (Bassanini and Duval, 2006; and Chetty et al., 2011). Elasticities of labor supply are especially high for low-skilled workers, women, and older workers. Given the wide divergence in labor market challenges, job strategies should take into account both short- and medium-term objectives. Where unemployment has risen sharply in the wake of the crisis, an immediate priority is to support employment growth. Options include lowering labor taxes and enhancing active labor market policies (ALMPs; See Table). Fiscal policy measures to foster higher labor force participation will affect employment only in the medium to long run, but should not be delayed. Examples of these policies include child-care subsidies and tax policies that do not discourage second earners. Countries with tight fiscal constraints should prioritize reform options that are budget-neutral or can provide budgetary savings, such as reforms that link the receipt of social benefits to job search requirements. Reforms should aim to mitigate trade-offs between employment and equity, including through greater use of in-work tax credits and benefits that increase incentives to work.

**Table: Potential Fiscal Policy Measures to Increase Employment**

| | Fiscal Policy Measures | |
|---|---|---|
| | Expenditure policy | Tax policy |
| Policies to increase labor demand | • Implement hiring and wage subsidies<br>• Introduce employment support schemes<br>• Implement public work programs | • Reduce labor taxes (fiscal devaluation: shifting from labor to consumption taxes)<br>• Lower business taxes |
| Policies to increase labor supply or facilitate matching | • Expand effective ALMPs<br>• Tighten eligibility criteria and job search requirements for social benefits<br>• Reduce the duration and level of social benefits when too high<br>• Increase child-care subsidies<br>• Increase effective retirement age<br>• Strengthen rules for disability pensions | • Reduce labor tax wedge, targeted to:<br>• Women/secondary earners (moving from family taxation to individual taxation)<br>• Older workers (earnings tax credits)<br>• Low-skilled workers (tax relief to and in-work tax credits) |

Source: IMF (2012b).

## A. Developing Countries

25. **Developing country labor markets differ from advanced country labor markets in fundamental ways and the policy challenges are commensurately very different** (Cho et al., 2012). In developing countries, a significant proportion of employment is in "own account" work, including in subsistence agriculture, rather than in paid employment. A much smaller proportion of workers are employed in formal jobs than in advanced countries. Since labor is abundant and capital scarce, there tends to be significant underutilization of labor, or underemployment, and thus a prevalence of working poor. Labor markets tend to be fragmented (rural vs. urban, skilled vs. unskilled, and formal vs. informal) and mobility is more limited. Female labor force participation rates are very low and working women are disproportionately present in lower end jobs and informal sector work. Many developing countries are facing a demographic bulge with large increases in the working age population. Finally, economic restructuring and labor reallocation as predicted by classic development models has taken place much more slowly. The ongoing megatrends of globalization and technical change increase uncertainty about the relevance of those development models and make it even more difficult for countries to chart a course of development and job creation. Thus, in these countries, job creation strategies need to be focused on creating the conditions for higher investment by the private sector (quality infrastructure including in agriculture, well functioning financial intermediation, and strong institutions of governance), equipping workers with basic education and job relevant skills, and protecting the working poor who are most exposed and vulnerable to exogenous shocks (weather cycles and other natural disasters) and the economic cycle. Female labor force participation can be enhanced through equal access to health and education services, legislation allowing women to participate in the labor market on an equal basis, and the removal of bottlenecks in infrastructure and transportation (see Annex 1). Formal labor market institutions directly affect only a small fraction of workers and thus their impact is most relevant for the creation and growth of more productive firms and for firm size.

26. **Albeit tentative, the conclusions of empirical research suggest that formal labor market institutions in developing countries have modest impacts on aggregate employment, reducing income inequality for those that are covered by them but deepening labor market duality** (Betcherman, 2013).

*Micro flexibility*

- *Employment protection:* Results for employment protection legislation (EPL) tend to be inconclusive, but some suggest negative employment effects, in particular on new hiring of some disadvantaged groups (e.g., young workers). While the evidence on the impact of job security rules on levels of employment and unemployment is inconclusive, the effect of EPL on labor market dynamics is much clearer. More stringent EPL is associated with smaller labor market flows in response to different states of the labor market, and therefore slows down structural transformation and the speed of adjustment to shocks and results in higher incidences of long-term unemployment.

- *Mandated benefits*: Mandated benefits, such as unemployment benefits, are less common in developing countries. There has been little research, but informality and incomplete enforcement are likely to result in small, if any, employment effects.

*Macro flexibility*

- *Minimum wages:* Minimum wages have either small negative effects or no effect on aggregate employment. But for specific groups of workers (youth, women, and workers in small firms) the effects on employment are negative. Non-compliance because of large informal sectors or weak enforcement may explain small effects. As for the impact on wages, virtually all studies that estimate the wage effect find that formal-sector wages rise with higher minimum wages. Somewhat surprising has been the observation that increases in the minimum wage often raise, rather than depress, wages in the informal sector. The empirical research is also consistent in demonstrating that the minimum wage compresses wage distributions and reduces earnings inequality.

- *Labor unions and collective bargaining:* The role of labor unions and collective bargaining in developing countries is limited by the large informal labor markets. Data on union influence is also scarce. As a result, while some studies find significant union wage premiums, there is no conclusive evidence of employment effects.

27. **Overall, the literature suggests the following as a sensible set of policies for a jobs strategy in developing countries**:

- Macroeconomic stability remains critical, with the understanding and acceptance that inflation is a regressive tax and disproportionately hurts the poor.

- Financial inclusion (access to banking services and credit, but also to risk and insurance products), particularly for women, is critical to reducing vulnerability from being involved in activities that are subject to exogenous shocks beyond the control of the workers.

- The focus must be to create the environment for both public and private investment in physical infrastructure such as transportation, and energy to facilitate the creation of jobs.

- Public policy and private efforts are needed to enhance education and job related skills aimed at employability and making transition between sectors and productivity levels.

- Finally, a robust social protection scheme (such as designed under the Social Protection Floor initiative), also addressing the needs of informal sector workers including women, is critical.

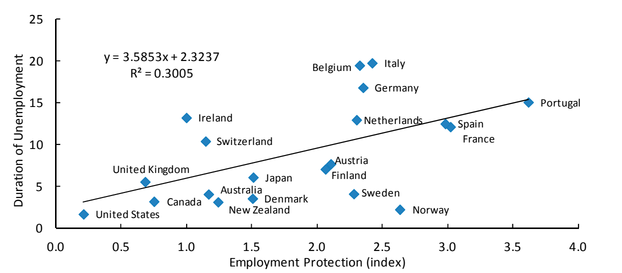
## B. Advanced Countries

28. **As for advanced countries, recent Fund research confirms the view that growth is generally necessary for job creation** (Ball, Leigh, and Loungani, 2013). Where this is the case, the best jobs strategy likely consists of a combination of a growth strategy and suitable labor market policies (i.e., policies affecting labor market institutions such as employment protection and unemployment insurance). As noted above, appropriate policies will need to allow for both micro and macro flexibility.

*Micro flexibility*

29. **The evidence suggests that to help micro flexibility, workers should be protected mostly through unemployment insurance rather than high employment protection**—the so-called "flexicurity" model of Nordic countries.[12] Without adequate insurance schemes, income insecurity could increase. Unemployment insurance can be generous, but only if ALMPs are in place and effective. There is a role for employment protection, but it should be limited, linked to the length of employment in the firm, and without threshold effects. High employment protection levels are associated with high unemployment durations, as shown in the Figure 5.

**Figure 5. Unemployment Duration and Employment Protection**



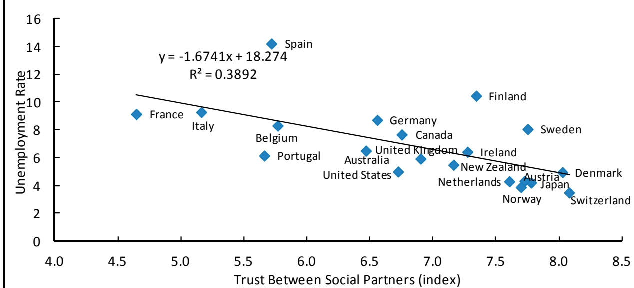

Source: Organisation for Economic Co-operation and Development (OECD) and International Labor Organization (ILO).

[12] The "flexicurity model" often credited for the success of the Nordic countries, is essentially based on the principle of generous unemployment insurance, which however is conditional on active job search and job acceptance. It also places strong emphasis on active labor market policies instead of high employment protection, hence shaping the notion of "protecting workers, not jobs" (see also Box 1).

30. **Dual employment protection, where high employment protection on permanent contracts coexists with lighter regulation for temporary contracts, should be avoided**. In response to firms' demands for more flexibility, reforms of employment protection have often introduced dual protection systems, with high employment protection on permanent contracts coexisting with lighter protection for temporary contracts. In many cases, these reforms have had ambiguous effects, both on efficiency and on welfare. Constraints on renewing temporary contracts have led firms to invest little in their temporary workers. And temporary workers, who are typically the young, have suffered from a high level of employment insecurity, alternating between dead end jobs and unemployment.

31. **One main question however is whether the "flexicurity" model can be exported**, or whether the success of Nordic countries reflects underlying factors, such as the degree of trust between firms and workers, which may not be easily replicable. (Figure 6 shows the strong bivariate relation between a trust measure and unemployment across countries.) In particular, trust is difficult to build, and where it does not exist, alternatives may need to be considered. For instance, when trust is weak, a stronger role for setting wage floors at a national level should be considered.

**Figure 6. Unemployment and Trust[1]**




*Source: Organisation for Economic Co-operation and Development and World Competitiveness Report. [1]Trust between firms and workers is measured by the extent to which industrial relations are perceived to be conducive to labor peace.*

*Macro flexibility*

32. **The institutions that appear to matter most for macro flexibility are the minimum wage, the tax wedge (which can affect primarily the average level of unemployment and labor force participation), and the collective bargaining structure** (which can affect not only the level but also the responsiveness of unemployment). The purpose of the minimum wage is to make sure that low skill workers receive a wage high enough to live on. It has led to a long debate about its welfare and efficiency effects, with the standard argument that a minimum wage may exclude low skill workers from employment, and may therefore have both adverse welfare and efficiency effects. The empirical evidence suggests that, within a range, the effect on employment may be small.[13] The minimum wage can act as a floor to avoid exploitation, but more substantial redistribution can be better achieved through a combination of a low minimum wage and well targeted social transfers (including negative income taxes).

[13] Schmitt 2013 reviews recent research on the minimum wage and finds that "the weight of evidence points to little or no employment response to modest increases in the minimum wage." The paper also surmises that there are a number of reasons for the limited impact including "reductions in labor turnover; improvements in organizational efficiency; reductions in wages of high earners ('wage compression"); and small price increase."

33. **Tax wedges—the difference between the cost of a worker to the firm and take home pay—primarily affect labor force participation**. Tax wedges are particularly high in Europe. Some payroll taxes, such as retirement contributions, come with deferred benefits, and should in principle have little effect on the cost of labor to firms, and therefore, labor demand. Strengthening this link (for example, by fully adjusting pension benefits for years of contribution) could help boost employment (IMF, 2012b). Even where the connection between taxes and corresponding benefits is very weak, theory often predicts that the incidence falls mostly on workers rather than on firms, and will primarily affect labor supply incentives. To the extent however that minimum wages or unemployment insurance limit wage reductions in response to demand shocks, the tax wedge will increase the cost of labor to firms, and thus increase unemployment. Shifting to other taxes (such as consumption taxes) may indeed support job creation (IMF, 2012b).

34. **The structure of collective bargaining can affect both the level and the fluctuations in unemployment**. Theory makes ambiguous predictions about the effect of collective bargaining on the level of unemployment. On the one hand, under centralized national bargaining, worker representatives are more likely to put some weight on the welfare of the unemployed than they are under firm-level bargaining. This should lead to lower unemployment. But, on the other hand, relative to firm-level bargaining, centralized bargaining also increases the bargaining power of unions, and is likely to lead to higher wages, and thus to higher unemployment.

35. **The structure of collective bargaining also influences the responsiveness of wages to unemployment**. Not all macroeconomic shocks require an adjustment of wages. But there are also cases when wages are too high, and must decline, at least relative to productivity, in order to decrease unemployment. An example is a loss of competitiveness in a country that has either a fixed exchange rate, or is part of a currency area, the problem facing periphery Euro Area countries. In this case, theory suggests that centralized bargaining is likely to dominate firm-level bargaining, for two reasons: First, because it is likely to give more weight to the welfare of the unemployed than firm-level bargaining. Second, because it can solve a coordination problem. When wages are negotiated at the firm level, a decrease in the wage at a given firm is a decrease in the relative wage, something that workers may not be willing to accept. The process of adjustment in which all wages, and in turn prices, adjust is likely to be protracted. When wages are negotiated at the centralized level, wages can be adjusted at once, without changes in relative wages. And firms can commit to passing decreases in costs into prices.

36. **The research on this topic suggests that the devil is in the details and that a combination of national and firm level bargaining seems best**. Firm-level agreements can adjust wages to the specific conditions faced by firms. National agreements can set floors, and, when needed, help the adjustment of wages and prices in response to major macroeconomic shocks. The fact that such agreements are rare, and have not been implemented in any of the Euro Area periphery country during this crisis, points again to the potential role of trust. It may be that, to succeed, trust is needed more than any particular bargaining structure.

**Box 1. "Protect Workers, Not Jobs"**

**The view that government policy should aim at protecting workers rather than specific jobs has gained wide support**.

- For example, the Growth Commission wrote: "Growth entails a structural transformation of the economy, from agriculture to manufacturing, from a rural workforce to an urban one. This transformation is the result of competitive pressure. Governments committed to growth must therefore liberalize product markets, allowing new, more productive firms to enter and obsolete firms to exit. They must also create room to maneuver in the labor market, so that new industries can quickly create jobs and workers can move freely to fill them." "Policy makers should resist calls to protect industries, firms, or jobs, but they should endeavor to protect people. Perhaps the best protections a government can provide are education, which makes it easier to pick up new skills, and a strong rate of job creation, which makes it easy to find new employment. Beyond that, governments should also establish social safety nets—which provide a source of income to people between jobs—and ensure uninterrupted access to basic services" (Growth Commission Report, Overview, p. 6).

- WDR 2013 adds: "Protecting workers or protecting jobs? The conventional wisdom is that policies that protect people are preferable, because they mitigate welfare losses while at the same time allowing the reallocation of labor, hence supporting creative destruction. Protecting jobs that are no longer economically viable through government transfers and employment protection legislation freezes an inefficient allocation of resources. Protecting jobs also entails a high risk of capture. It may lead to enduringly unproductive jobs, stifle technological advance, prevent structural change, and eventually undermine growth." "Protecting people should have primacy if shocks are idiosyncratic—if the employment dislocation is local and limited and if turnover continues to be the norm. Protecting jobs may be warranted in times of systemic crises or major economic restructuring. But job protection policies can create permanent inefficiency, especially in countries with weak institutions, making it indispensable to establish and enforce trigger rules and sunset clauses that define the extent and size of the protection" (WDR 2013, p. 37).

# V. INCLUSIVE GROWTH

37. **Many governments care not just about the level of growth but also about the distribution of its benefits**.[14] In developing countries and some emerging markets poverty reduction remains firmly on the policy agenda, but in recent years concerns about rising inequality and high unemployment have prompted a growing number of governments and multilateral agencies to adopt a goal of "inclusive growth". In advanced economies too, there is now heightened concern about the distribution of income especially since financial crises generally worsen inequality and that the impact is larger the more serious the associated recession because the burden of adjustment is borne by wage earners (Bordo and Meissner, 2011).

38. **There is no single commonly-accepted definition of inclusive growth but a number of broadly similar concepts are used in the policy dialog**. The World Bank defines it as growth that is high and sustained (a crucial condition for poverty reduction); broad-based across sectors and inclusive of a large part of the country's labor force (issues of structural transformation and economic diversification thus take center-stage); and characterized by equality of opportunity in terms of access to markets and resources. The focus of this definition is on productive employment

[14] This section draws on Dabla-Norris (2012).

for all groups including women, rather than on income redistribution, as the means of increasing incomes for the excluded. Definitions offered by other institutions are summarized in Box 2. The common core is that inclusive growth refers to the goal of fostering higher growth while also providing productive employment; providing equality of opportunity so that all segments of society can share in the growth and employment; and redressing some of the inequalities in outcomes, particularly those experienced by poor and vulnerable segments of the populations.

### Box 2. Inclusive Growth: No Definition Left Behind

- The UN definition places somewhat greater emphasis on social protection. Inclusive growth "refers to the notion of achieving material progress through economic growth while encompassing equity, equal opportunity to basic service provision, access to the key markets (labor and credit), and social protection for the most vulnerable in society." (Addison and Niño-Zarazúa, 2012).

- The Asian Development Bank defines inclusive growth as "growth coupled with equality of opportunity" (Asian Development Bank, 2012). In particular, growth is viewed as "inclusive when it allows all members of a society to participate in and contribute to the growth process on an equal basis regardless of their individual circumstances."

- The African Development Bank defines inclusive growth as "economic growth that results in a wider access to sustainable socio-economic opportunities for a broader number of people, regions or countries, while protecting the vulnerable, all being done in an environment of fairness, equal justice, and political plurality" (African Development Bank, 2012). Inclusive growth is broad-based growth across sectors; includes productive employment, and protects disadvantaged and marginalized groups from adverse shocks.

- In making the case for the Europe 2020 strategy, the European Commission (2010) spells out a range of considerations that inclusive growth encompasses: (i) making full use of labor potential; (ii) combating poverty and its consequences; (iii) advancing social inclusion (focusing attention on opportunities and obligations over the life cycle); and (iv) ensuring territorial cohesion (preventing or reducing the extent of regional disparities).

39. **An important distinction when discussing distributional equity is that between inequality of outcomes (*ex post*, as proxied by income or expenditure) and inequality of opportunity (*ex ante*)**. Inequality of opportunity relates to differences in circumstances beyond the individual's control, for example variations in access to basic services (e.g., health, education, and infrastructure) and to financial and labor markets by gender, ethnicity, age, etc., whereas inequality of outcomes also reflects individual effort in addition to access to opportunities.

40. **An inclusive growth strategy can also be an effective poverty reduction strategy**. In contrast to pro-poor growth, inclusive growth entails a focus not only on one group but more generally on those parts of the population or the labor force that are excluded from the growth process or do not get the opportunity to participate in economic processes according to their potential, as for instance women. A further link is that income inequality also affects the pace at which growth translates into poverty reduction: growth is less efficient in lowering poverty in countries with high initial inequality or in which growth benefits mainly the non-poor (Ravallion, 2004).

41. **Inclusive growth is important not just for social cohesion but indeed for sustained growth**. As stated in Berg and Ostry (2011), "the relationship between income inequality and economic growth is complex. Some inequality is integral to the effective functioning of a market economy and the incentives needed for investment and growth. But inequality can also be destructive to growth, for example by amplifying the risk of crisis or making it difficult for the poor to invest in education."

42. **There are a number of reasons to believe that excessive inequality can have significant negative implications for both longer-term growth and macroeconomic stability**. This is best shown by presenting the dangers that may arise from the absence of inclusion through various economic, social, and political mechanisms.

- *Inequality and underinvestment*. Inequality of wealth and income can lead to wasted productive potential and a misallocation of resources, undermining long-run growth. Those with little wealth or low income may be unable to invest in human capital, or wealth- and income-enhancing productive activities if imperfections in financial and other markets constrain their ability to borrow. Banerjee (2004) points to a range of microeconomic evidence that shows under-investment in agriculture and human capital in unequal societies, reflecting limited ability by the poor to invest. (The extent to which such interactions between inequality and market failures reduce overall efficiency depends on institutions and policies.) The tendency for inequality to lead to underinvestment by the poor may also be part of the reason why in countries with a higher degree of inequality, a larger part of individuals' incomes is determined by factors outside of their control, such as their parents' incomes (Figure 7). In other words, the higher is inequality, the lower tends to be social mobility. A lack of social mobility, in turn, could conceivably act as a disincentive to individual effort, also contributing to lower growth. In a similar vein, Acemoglu and Robinson (2012) argue that economic and political inclusion is essential for long-term development.

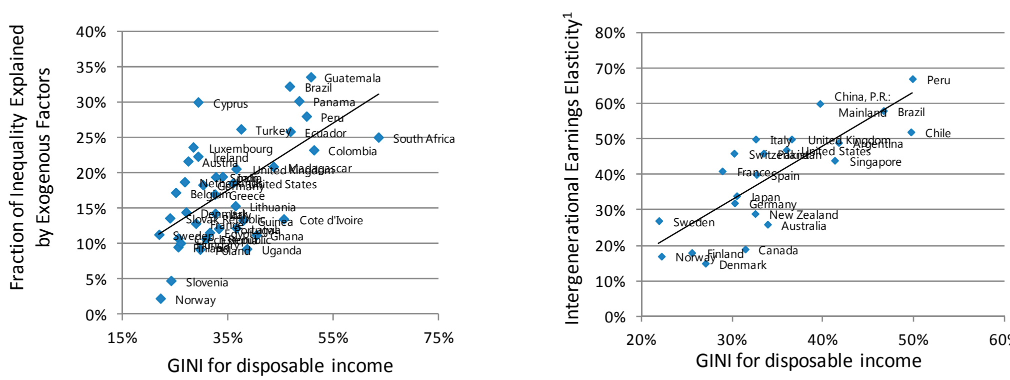
**Figure 7. Income Inequality and Social Mobility**

**Income Inequality and Fraction of Inequality Explained by Exogenous Factors**

The higher is income inequality, the higher is the fraction of inequality that can be explained by factors beyond an individual's control, ...

**Income Inequality and Intergenerational Immobility**

... and the lower is social mobility, implying possible losses to long-term growth.




Source: Brunori, Ferreira and Peragine (2013), Solt (2009).

[1]A high elasticity signifies a close relationship between the incomes of parents and children. Source: Corak (2012), Solt (2009).

- *Unemployment, growth, and inequality*. High unemployment and/or low labor force participation rates can impose large economic and social costs:

  - If there is learning-by-doing among the employed, high or prolonged unemployment will have adverse effects on growth. Similarly, long unemployment spells may cause a loss in skills, potentially making some unemployed permanently unemployable. But even without such mechanisms, high unemployment may have an adverse effect on growth because it reduces the pool of savings available for investment, be it in physical or human capital or in knowledge-creating activities (Bean and Pissarides, 1993).

  - Labor utilization influences income distribution. Unemployment is found to have a regressive impact on income equality, and a higher employment rate is associated with lower economic disparities. The longer the unemployment duration, the higher the income inequality (Morsy, 2012). In countries with sizeable youth unemployment, this can be exacerbated as scarring effects ranging from slow growth in labor earnings to job-related dissatisfaction may affect a sizeable proportion of the labor force (Bell and Blanchflower, 2011).

  - The misallocation of women's labor as a result of discrimination, social norms, or lack of opportunity results in economic losses in both advanced and developing countries (Stotsky, 2006). Based on ILO data, Aguirre (2012) estimates that 865 million women worldwide have the potential to contribute more fully to their national economies, out of whom 812 million live in emerging and developing nations. In advanced economies with aging populations, raising the female labor force participation rate can reduce the dependency ratio and enhance growth (Steinberg and Nakane, 2012).

- *Distributional conflict*. High unemployment and inequality can lead to latent social conflict, which manifests itself through political struggles for public resources, with adverse implications for macroeconomic outcomes. In essence, different social groups have different interests, and the outcome of the political process through which those interests are reconciled may lower growth (efficiency-equity tradeoff).

  - Political processes may seek to effect redistributions, but in ways that have high economic co*sts* (e.g., creating disincentives to work or to save). Once social costs and benefits are taken into account, political outcomes may generate levels of unproductive government spending that are too high (Alesina and Rodrik, 2004).

  - Political processes might be insufficiently redistributive, with powerful groups capturing economic privileges from budgets or financial systems. This can either lead to lack of action in areas that could bring greater equity and greater efficiency (e.g., investments in public education) or the perpetuation of institutional structures that favor particularly powerful groups at costs to aggregate performance, for example via connected lending, high levels of protection, and outright corruption (Bourguignon et al., 2007).

- *Open social conflict*. Under some conditions, inequality and joblessness can be associated with open social conflict (violent conflict and civil war), which undermines social cohesion and economic performance. For instance, youth unemployment can be particularly disruptive for societies and in some settings contribute to participation in violent activities (World Bank, 2011).

- *Macroeconomic crises*. One particularly costly way for distributional conflicts to play out is to contribute to macroeconomic crises. As such, macroeconomic instability can be both product and cause of underlying inequalities and associated weak institutions.

    - Rajan (2010) and Reich (2010) suggest that increases in borrowing and household debt in the United States that foreshadowed the global crisis were a way for the poor and the middle-class to maintain or increase their level of consumption at times when their real earnings were stalling (see also, Kumhof and Ranciere, 2010). Acemoglu (2011) argues that increased inequality and the crisis were the consequence of politicians' willingness to deregulate the financial sector, which partly reflected financial industry lobbying. Using data from past financial crises, Atkinson and Morelli (2011) find that while causality from inequality to crises is difficult to establish as economic crises differ a great deal in whether they were preceded by rising inequality, financial crises are generally followed by rising inequality.

    - Macroeconomic instability can interact with inequality to reduce growth. Rodrik (1999) argues that the negative effects of external shocks in the 1970s on growth were significantly larger in societies with latent distributional conflict (proxied by income inequality) and weak conflict management mechanisms (proxied by institutional strength and indicators of democracy).

    - Berg and Ostry (2011) found that the less equal is a country's income distribution, the shorter tends to be the duration of periods of high growth.

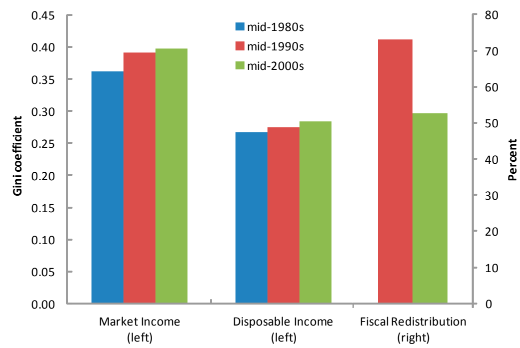
- *Risk and insurance*. Inequality and unemployment/underemployment matter for individuals' ability to cope with risk. In highly unequal societies, insurance mechanisms to buffer income and smooth the impact of the shocks on consumption are typically unavailable or only cover a small segment of the population, imposing large welfare costs. Similarly, the fragile segments of the labor market—young, low-skilled, and temporary workers—are more exposed to economic cycles, making them vulnerable to job instability.

43. **Creating productive employment opportunities throughout the economy is an important way to generate inclusive growth**. Beyond this, there are policies that can have a specific direct bearing on income distribution. Box 3 summarizes what is known on the redistributive role of fiscal policies, and Annex 5 does the same for financial sector policies.

## Box 3. The Redistributive Role of Fiscal Policy

**Fiscal policy has played a key role in reducing income inequality in advanced economies**. Over the past two decades, fiscal policy decreased inequality in market income (defined as income before taxes and government transfers) by about one-third in OECD countries, primarily through transfers (such as child benefits and public pensions) and income taxation. The redistributive impact is even higher when in-kind transfers for education and healthcare are included. The left two panels of the first Box Figure show market- and disposable-income inequality for working-age households, with the difference between these capturing the redistributive impact of fiscal policy in each time period. The Figure indicates that since the mid-1990s, disposable income inequality has increased more than market-income inequality due to the reduced generosity of redistributive benefits and the diminished progressivity of income taxes.

Redistributive Impact of Fiscal Policy in Advanced Economies

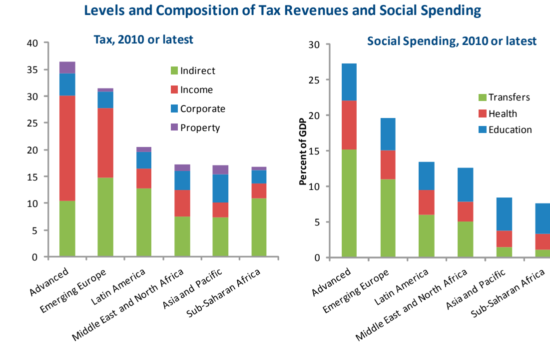



**Advanced economies could reinforce the redistributive role of fiscal policy in several ways**. These include greater reliance on wealth and property taxes, more progressive income taxation, removing opportunities for tax avoidance and evasion, better targeting of social benefits, and the reallocation of public spending to programs that strengthen the human capital of the poor, such as education and job training programs.

**In developing economies, fiscal policy has had much less impact on income inequality**. This, in turn, reflects their lower levels of taxation and public spending and the use of less progressive tax and spending instruments (Second Box Figure).

**Developing economies could implement fiscal policies that enhance redistribution, while also promoting growth and fiscal sustainability**. On the tax side, the focus should be to broaden tax bases through reduced tax exemptions, closing loopholes, and improving tax compliance, rather than raising tax rates. Revenue constraints are likely to remain tight, however, and fiscal resources will continue to be needed to finance spending that enhances growth, such as public investment that addresses infrastructure bottlenecks. This implies that greater emphasis will need to be placed on improving the progressivity of public spending through, for example, eliminating general price subsidies for energy; ensuring that education and health expenditures are targeted to meeting the needs of the poor, rather than providing subsidized services to upper-income households; and putting public pension systems (which highly favor upper-income groups in developing economies) on sound financial footing, while expanding coverage of minimum "social pensions" to a larger share of the population.

Levels and Composition of Tax Revenues and Social Spending




Source: Bastagli, Coady, and Gupta (2012).

44. **A long-standing question in the economics literature is whether there is a trade-off between economic growth and income inequality**. Although it is well documented that growth is a necessary condition for enhancing welfare on a sustainable basis, many development economists have argued that there is a trade-off between growth and the equality of income distribution. One argument made in the pioneering work of Kuznets (1955) is that the reallocation of labor and other resources from low-productivity sectors to higher-productivity sectors provides middle- and upper-income groups with greater benefits than the lower-income groups, resulting in a more unequal income distribution. He showed that income inequality initially increased, reached a peak, and then declined with economic development and that low- and high-income countries have less inequality than middle-income countries. Another argument is that, to enhance economic growth, there is a need for more investment and domestic savings. Since the marginal propensity to save can rise with income levels (including due to liquidity constraints for lower-income workers, bequest motives, and habit formation—i.e., spending habits adjust only slowly to increased earnings), a distribution of income in favor of the relatively well off may be needed to generate higher savings and investment (Keynes, 1937; and Kaldor, 1955). Other arguments are that greater inequality gives people (i) the incentive to work harder and thereby boost productivity and growth (Friedman, 1955) and (ii) the incentive to invest in their education which boost productivity and growth (Becker 1985). These authors believe that public policies aimed at redistribution come with distortions in the form of higher taxes, reduced work effort, and lower productivity.

45. **While empirical evidence on this question is vast but inconclusive, recent work by the OECD highlights that there are both complementarities and trade-offs between policies reducing inequality and those promoting economic growth**. Empirical studies have found both positive and negative correlations between inequality and growth. For example, Alesina and Rodrik (1994) find that inequality is negatively correlated with economic growth, while Forbes (2000) finds that income inequality has a positive impact on economic growth in the short and medium term. Banerjee and Duflo (2003) argue that difficulties to identify a clear empirical relationship between income inequality and growth are explained by non-linearities. The OECD (2012a, Chapter 5) notes the following:

- "Many policies entail a double dividend as they reduce income inequality while at the same time boosting long-run GDP per capita. Examples include facilitating the accumulation of human capital, making educational potential less dependent on personal and social circumstances, reducing labor market dualism, promoting the integration of immigrants, and fostering female labor market participation. Concerning taxation, reducing tax expenditures, for instance for investing in housing, contributes to equity objectives while also allowing a growth-friendly cut in marginal tax rates.

- By contrast, several policies may entail a trade-off between reducing income inequality and raising GDP per capita. For instance, administrative extensions of collective wage agreements may reduce wage earnings dispersion among workers, but if they set labor costs at too-high levels for some employers they may harm competition and productivity and possibly reduce employment. Shifting the tax mix to less-distorting taxes—in particular away from labor and corporate income taxes towards consumption and real estate taxes—would improve incentives to work, save and invest, but could undermine equity. Cash transfers targeted to lower incomes can be used to ease this trade off.

- Finally, some policies aimed at boosting GDP per capita have an uncertain impact on income inequality. For instance, avoiding too-high and long-lasting unemployment benefits may raise employment over the long run but also widen the distribution of income among workers, with an ambiguous net effect on inequality. The same holds as regards keeping minimum wages at moderate levels."

As demonstrated by the experiences of Sweden and Brazil, maintaining a high degree of equality (Sweden) or lowering inequality from a high level (Brazil) does not have to result in low growth if appropriate policies are taken (Annex 6).

# VI. TAKING STOCK OF RECENT SURVEILLANCE AND PROGRAM WORK

46. **This section reviews the way in which growth and job creation issues have been discussed in Fund surveillance and incorporated in Fund-supported programs in recent years**. Article I of the Fund's Articles of Agreement lists "the promotion and maintenance of high levels of employment and real income" among the purposes of the institution.[15] This purpose has been reaffirmed over the years, with Fund management and the Board often stressing its importance for social stability (Box 4 provides a brief history of the Fund's engagement on growth, jobs, and equity.)

- *Surveillance:* As noted in Annex 7, the Fund is required to assess, inter alia, whether a member's domestic policies are directed towards the promotion of domestic stability. With regard to growth, this requires the Fund to examine whether domestic policies are directed toward keeping the member's economy operating broadly at capacity. It also requires the Fund to examine whether domestic policies are directed towards fostering a high growth rate of potential GDP where this significantly influences prospects for domestic stability. Issues related to job creation and income distribution should also be examined if they have a bearing on domestic stability. Further, to the extent that job creation and better income distribution are important objectives for a member country, the Fund should advise the member on policies that would promote stability, while also helping the member to achieve these objectives. Finally, even if there is no clear link to domestic stability and the authorities have not identified issues related to job creation and income distribution as being of particular importance to them, these issues may be discussed in an Article IV consultation if the member country requests the Fund's advice.

[15] Specifically, Article I (ii) lists as a purpose of the Fund "to facilitate the expansion and balanced growth of international trade, and to contribute thereby to the promotion and maintenance of high levels of employment and real income and to the development of the productive resources of all members as primary objectives of economic policy."

- *Fund-supported programs:* The purpose of Fund-supported programs is to assist members in correcting "maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity" and "achieving medium-term external viability while fostering sustainable economic growth." Thus, while ensuring that members achieve the primary goals of correcting their balance of payments problems and achieving external sustainability, Fund-supported programs should help maintain and strengthen growth as much as possible. In addition, the Fund may encourage and assist a member in pursuing its own objectives related to inclusive growth and employment as part of its program if these objectives are consistent with the primary goals. Beyond this, Fund-supported programs financed by the Poverty Reduction and Growth Trust (PRGT) have the explicit purpose of helping low-income countries "achieve, maintain, or restore, a stable and sustainable macroeconomic position consistent with strong and durable poverty reduction and growth." Program-related conditions such as structural benchmarks, including those related to growth, job creation, and income distribution, need to be of macro-critical importance for achieving the program goals or for monitoring implementation of the program.

47. **The 2011 Triennial Surveillance Review (TSR) updated further guidance on the extent to which unemployment, inequality, and poverty should be taken up in surveillance**.[16] In analyzing this issue, the review noted that several considerations are important: (i) the purpose of the Fund, as defined in Article I, to contribute "to the promotion and maintenance of high levels of employment and real income"; (ii) the tension between the breadth and the depth of analysis—in this respect the 2004 TSR called for "more discriminating coverage of issues outside the Fund's traditional areas of expertise" and the 2008 TSR argued that "recent gains (for example, in focus) should be preserved"; and (iii) the fact that other institutions, e.g., the World Bank, the OECD, and the ILO, may have greater expertise on social issues, in particular on labor market issues. At the same time, the 2011 TSR noted that Fund surveillance must be selective, with the overall focus on individual members' macroeconomic stability, as well as the effective operation of the international monetary system. To strengthen relevance and generate greater traction of Fund advice, the 2011 TSR therefore recommended covering macro-social issues in Article IV consultations that pass the test of being critical to the assessment of members' stability, leveraging effectively other institutions' expertise.

[16] The TSR can be found at: http://www.imf.org/external/np/spr/triennial/.

### Box 4. A Brief History of the Fund's Engagement on Growth, Jobs, and Equity

**The Fund's engagement with growth dates back several decades**. As discussed in Boughton (2000), the Fund's role as "a guiding force in economic development" expanded during the 1970s with "development-oriented activities such as lending for longer maturities and on concessional terms." Fund Managing Director Johan Witteveen "encouraged the staff to work on issues related to the alleviation of poverty and the provision of basic human needs" and expanded the Fund's interaction with the United Nations, including UNICEF and UNDP. Under the next two Managing Directors, Jacques de Larosière and Michel Camdessus, "the Fund became more deeply entrenched in the task of helping developing countries formulate beneficial and sustainable economic policies" to promote growth. This direction has been reflected in some of the work carried out by staff since the 1980s.[1]

**The dialogue with the ILO on jobs intensified in the 1980s**. Starting in the late 1980s, the ILO sought to engage the World Bank and the Fund on employment promotion and labor market policies, core labor standards, and social protection policies. In 1987 the ILO convened the High-Level Meeting on Structural Adjustment and Employment at which many participants called upon the World Bank and the Fund to adopt more "aggressive strategies geared to job creation in privatization initiatives and less dramatic job losses in the public sector" in structural adjustment policies (Hagen, 2003). Managing Director Camdessus spoke at the annual ILO Conference in June 1991 (launching a practice of frequent participation by Fund management at this conference since that time). In 1995, the World Bank and the Fund invited the ILO to accept observer status at their annual meetings. That year, the Fund and the ILO also agreed to strengthen their cooperation at the country level, with three countries—India, Costa Rica, and Zimbabwe—chosen as pilot cases to carry out this intent. Collaboration between the Fund and the ILO was further intensified at the 2010 Oslo Conference on Growth, Employment, and Social Cohesion, which saw the adoption of a three-pillar agenda for cooperation. This consisted of joint work on social protection floors in low-income countries, joint social dialogue country consultations, and joint analysis and research on strategies to encourage job creation and growth. Fund-ILO collaboration is set to continue going forward. Likewise, there has been a steady stream of Fund work on employment issues.[2]

**Equity issues are not new to the Fund either**. Equity issues gained prominence in the late 1980s with the growing awareness of the links between inequality and the sustainability of adjustment programs. Since then, there has been widespread recognition of the need to protect vulnerable groups during structural and fiscal adjustment by constructing social safety nets and safeguarding access to basic public services such as primary health and education.[3] Fund-supported programs, especially in low-income countries (LICs), began to pay greater attention to the social dimensions of adjustments. The emphasis in LIC Fund-supported programs on raising health and education spending was also a catalyst for greater attention to issues related to the composition of government expenditures. To help direct the work of the Fund staff, guidance notes from management on income distribution and social expenditures were issued in 1996 and 1997, taking account of the how staff should discuss these issues within the context of the Fund's mandate. The Fund also expanded its analytical work on equity issues, drawing on the work of leading academics in this area.[4] In Fund-supported programs, the broadening of the focus to distributional issues, albeit limited to the bottom of the income distribution, was reflected in the creation of the Poverty Reduction and Growth Facility (later PRGT). Analytical and policy work on equity issues continued in the 2000s both inside and outside the Fund, providing a solid foundation for the design of policies that can enhance equity.

[1] For instance, Khan and Montiel (1989) argued that "adjustment can only be judged successful if it brings about a rate of growth of output that allows for a steady improvement in per capita income and living standards."

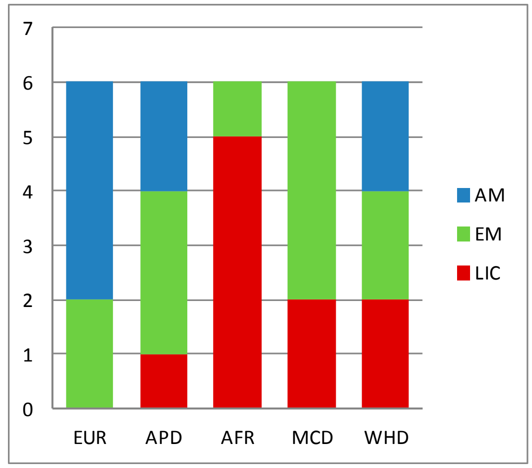
[2] These issues include the relative employment performance of the United States and Europe (Larsen, 1997), the challenges facing China's labor markets (Brooks and Tao, 2003) and the MENA region (Gardner 2003), and the role of women in economic growth (Stotsky 2006).

[3] See "Social Dimensions of the IMF's Policy Dialogue," IMF Pamphlet No. 47 (1995); and Chu and Gupta, (1998).

[4] See Tanzi and Chu (1998); and Tanzi, Chu, and Gupta, (2000).

48. **A sample of 30 Article IV reports discussed by the Executive Board during 2011-12 was reviewed for their approach to growth, labor markets, and inclusion**. The reports were chosen to be representative across geographical regions, resulting in the inclusion of six reports from each area department. Within regional groups, reports were chosen in such a way as to achieve a broadly representative distribution across income levels. In total, the sample includes reports for eight advanced market countries (AMs), 12 emerging market countries (EMs), and 10 low-income countries (LICs; Figure 8).[17] Note that this stocktaking provides only a snapshot of the most recent bilateral surveillance work. Much more work on issues of relevance for this report is being done at the Fund in other contexts and is presented, for example, in Board papers, World Economic Outlooks (WEOs), Regional Economic Outlooks (REOs), Staff Discussion Notes, and Working Papers. Some of this work will be identified as resources for enhancing surveillance and program work.

**Figure 8. Surveillance Sample: Number of Countries Among Departments and Income Groups**




49. **Findings are presented in Figure 9 and can be summarized as follows**:

- *Growth:* Broadly, the approach taken in surveillance towards fostering growth is to identify and recommend combinations of macroeconomic and financial policies best suited to bringing about or maintaining macroeconomic stability. The staff reports that were reviewed do distinguish between cyclical and structural factors affecting growth, with those for AMs and EMs often providing estimates of potential output and the output gap. Additional analyses of cyclical and structural factors could be found in most reports for AMs, less often in reports for EMs, and rarely in reports for LICs. This likely reflects the fact that the concept of potential output is less meaningful in countries undergoing structural changes, as well as data limitations. Further, while staff reports usually do not propose comprehensive long-term growth strategies, they frequently discuss a number of the determinants of long-run growth. Reports frequently discuss the business environment, governance, and infrastructure, and many reports for EMs and LICs recommend enhancing these determinants of long-run growth. Many reports also recommend financial sector reforms, aimed mainly at strengthening compliance with regulatory standards, and in EMs and LICs aimed also at broadening access to the financial sector.

[17] Further, to achieve a clear distinction between surveillance and program-related documents, Article IV reports that were also requests for programs were excluded, and where two Article IV consultations took place during 2011-12, one was excluded. Documents in the surveillance sample include staff reports for Ethiopia, Ghana, Mozambique, Republic of Congo, South Africa, and Zambia (all AFR); China, India, Japan, Nepal, South Korea, and Thailand (all APD); Germany, Italy, Latvia, Russia, Spain, and the United Kingdom (all EUR); Algeria, Lebanon, Mauritania, Pakistan, Tajikistan, and Tunisia (all MCD); and Brazil, Canada, Dominica, Guatemala, Nicaragua, and the United States (all WHD).

- *Labor market issues:* Staff reports routinely provide some discussion of labor market developments and labor market policies. Almost all reports describe short-term labor market conditions using such indicators as employment, unemployment, wages, and (except in reports for LICs) productivity. In addition, about half of staff reports for AMs and EMs and one third of reports for LICs also provide a more analytical treatment of labor market issues. However, overall the depth of the analysis appears limited, as indicated, for example, by the fact that only about half of reports for AMs distinguish between structural and cyclical causes of unemployment, and few reports for EMs and LICs do so. For EMs and LICs, data constraints may limit the scope for analysis. Also, in these countries a high degree of underemployment and informality makes analysis of developments in formal labor markets less relevant. Where labor market institutions are discussed, enhancing flexibility is a frequent theme, while concrete recommendations to this effect are made in about one quarter of reports.[18]

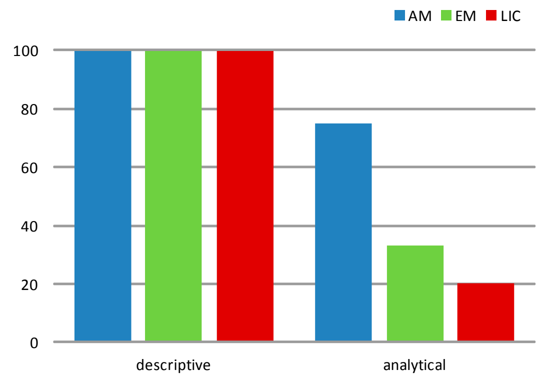
- *Inclusiveness:* Most staff reports provide some description of inequality, inclusiveness, and poverty, as well as of trends in social spending. This is particularly true of reports for LICs, as might be expected given the focus on poverty reduction, while there is somewhat less coverage in reports for AMs. As mentioned, many reports also recommend improvements to structural features such as the business environment, governance, infrastructure, and financial sector reforms, which support longer-run growth and inclusion.

- *Impact of macroeconomic policies on labor market outcomes and inclusiveness:* While many reports provide some discussion of the impact of recommended macroeconomic policies on labor market outcomes and the income of poorer segments of the population, there is limited discussion of options for mitigating this impact. Thus, for instance, while the majority of reports examined discuss the likely effect of fiscal consolidation on social spending, only few propose options for mitigating the resulting impacts on the poor. Reports also offer only a limited discussion of efficiency-equity trade-offs, and there is little apparent tailoring of policies to country preferences regarding such trade-offs. This said, it is possible that advice was tailored to country preferences without this being evident in the reports.

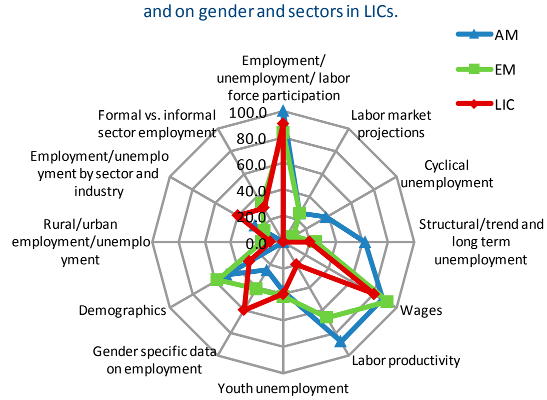
[18] The apparent tendency to recommend greater flexibility may reflect in part lingering effects of a near-consensus established by the influential OECD (1994) Jobs Study. The study recommended flexible rules for protecting employment and setting wages, and highlighted the benefits of unemployment and welfare systems that minimized work disincentives. By the mid-2000s, however, this consensus had largely disappeared. As methods had improved and better data had become available, the impact of labor market most institutions became less—not more—clear, and the influential OECD (2006) study "was more equivocal about almost all its recommendations than it had been 12 years earlier" (Betcherman, 2013).

## Figure 9. Stocktaking of Surveillance Documents

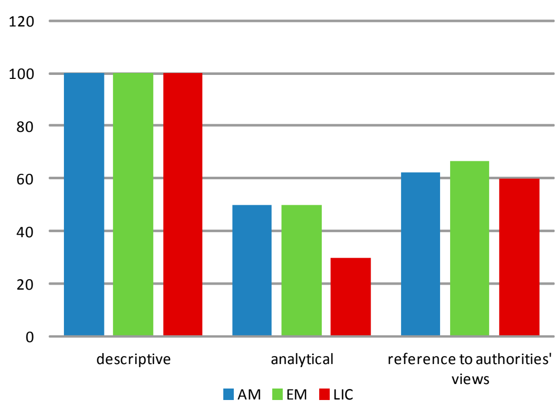
**Descriptive and Analytical Work on Cyclical and Structural Growth in Article IV Reports:** Almost all staff reports make a distinction between structural and cyclical causes of growth. Deep analytical work can be



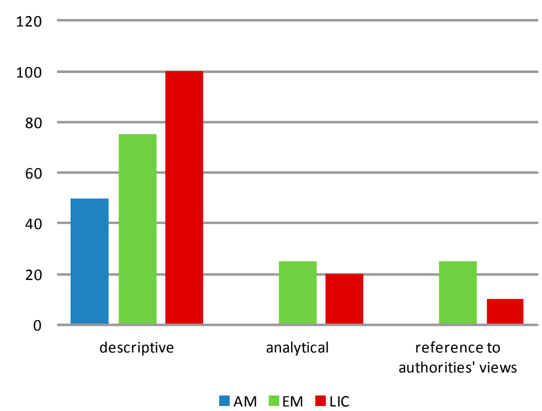

**Discussion of Labor Market by Country Group:** More focus on labor productivity and structural issues in AMs, on demographics in EMs, and on gender and sectors in LICs.



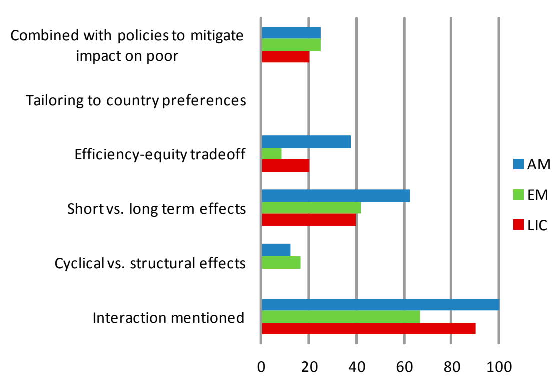

**Labor Market:** Some descriptives on the labor market are provided in all examined Article IVs - analytical work is rarer and more pronounced in EMs and AMs.



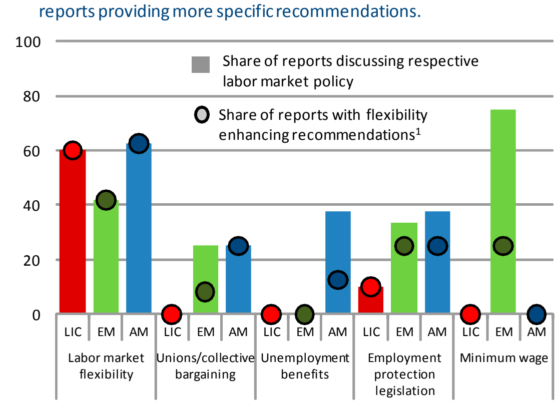

**Inclusiveness:** AMs are lagging behind EMs and LICs in providing decriptives on inequality or poverty. Analytical work and reference to authorities' views are rather limited in EMs and LICs and largely absent in AMs.




**Discussion of Macro Policies' Effect on the Labor Market, Inclusiveness, or Poverty:** Discussion took place in most examined reports, but tailoring advice to country preferences or efficiency-equity tradeoffs were seldom discussed.




**Labor Market Policies:** Many staff reports recommend enhancing labor market flexibility in general terms, with about one fourth of reports providing more specific recommendations.




[1]Less centralized/coordinated bargaining, lower unemployment benefits, less stringent employment protection legislation, lower minimum wage.

50. **The most recent guidance for the Fund's role in addressing jobs and growth issues in Fund-supported program is contained in the 2011 Review of Conditionality** (IMF, 2012c). The Review recommended that, where appropriate, program work should take greater account of macro-social issues than in the past. "This could include (i) more analysis of the social impact of policy measures in programs, in close cooperation with country authorities and institutional partners; and (ii) where feasible and appropriate, inclusion of policy measures to mitigate adverse short-term impacts on the most vulnerable, particularly in programs with high risks and large fiscal adjustment. This work needs to be mindful of the Fund's core areas of responsibility and competencies."[19]

51. **The Review examined several aspects of jobs and growth in Fund-supported programs since 2002, and found that Fund-supported programs are increasingly emphasizing social aspects**. Social spending in programs has been largely protected, and as shown by Clements, Gupta and Nozaki (2013), in the case of LICs, has increased as a share of both total expenditure and GDP. This development benefited from the establishment of indicative targets for social spending in a majority of LIC programs, as well as the emphasis on using the savings from debt relief under the Highly Indebted Poor Countries Initiative and the Multilateral Debt Relief Initiative for social and other purposes. In some programs, steps have been taken, including through structural benchmarks—for example, targeted transfers to the most vulnerable—to mitigate the impact of certain policy measures such as adjustment of utility tariffs or fuel prices.[20] Moreover, greater fiscal and external accommodation was incorporated in program design in the early phases of the recent global crisis (especially in the so-called Wave 1 program countries), enabling policymakers to minimize the immediate output costs of the crisis.[21] As regards growth, while the Review established the effects of programs on several key macroeconomic variables, effects on growth were on the whole ambiguous. This is in line with the lack of consensus in the academic literature on the impact of Fund programs. This being said, a recent staff analysis found a positive effect of long-term Fund engagement (at least five years in a decade) on growth in LICs (IMF, 2012d).

52. **The following is a summary of the coverage of jobs and growth issues in Fund-supported programs.** The sample consists of 30 program requests out of overall 32 requests discussed by the Board during 2011-12 (repeat requests for programs with Mexico and the Solomon Islands were excluded). The sample is thus near-comprehensive and consequently not balanced across geographic regions or income groups.[22] Figure 10 provides detail on distribution across

[19] See the Public Information Notice for the 2011 Review of Conditionality (http://www.imf.org/external/np/sec/pn/2012/pn12109.htm).

[20] In many cases, Fund technical assistance helped determine the impact of price adjustments on the poor and reviewed options to mitigate them.

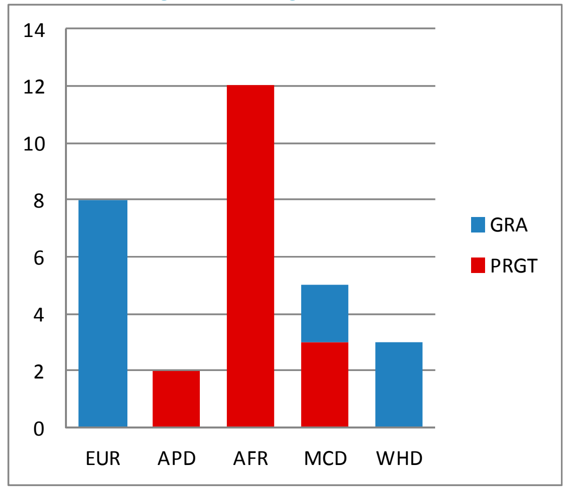
[21] Wave 1 countries include mainly emerging market countries seeking IMF assistance during the peak of the global financial crisis (2008-mid 2009). See the update of the 2009 Review of Crisis Programs, available at: http://www.imf.org/external/np/spr/2011/crisprorev/.

[22] Documents in the program sample include program requests for Burundi, Central African Republic, Cote d'Ivoire, Gambia, Guinea, Kenya, Liberia, Malawi, Mali, Niger, Sao Tome and Principe, and Tanzania (all AFR); Bangladesh and

(continued)

regions and income groups. The analysis focuses on discussions in program request documents and does not cover program conditionality. Findings are presented in Figure 11 and can be summarized as follows:

**Figure 10. Program Sample: Number of GRA and PRGT Programs Among Departments**




- *Growth:* The approach taken in programs towards fostering growth is to determine those changes in macroeconomic and financial policies that would bring about the necessary external adjustment and return to external and fiscal sustainability, while staying within the resource envelope determined by available financing and involving the smallest estimated damage to growth. As in surveillance, the question about which policies are best suited in any given situation depends on, among other things, the way in which cyclical and structural factors affect growth. In line with findings on surveillance, the stocktaking found that most program requests, and almost all requests for GRA-supported programs, make this distinction, while fewer requests provide comprehensive econometric analysis of the issue. Further, as is the case in surveillance, staff reports frequently discuss a number of the determinants of long-run growth and they regularly comprise a certain number of structural reforms aimed at enhancing efficiency and long-run growth.

- *Labor market issues:* Most program requests provide some description of labor market conditions, and about half discuss labor market policies. Requests for GRA-supported programs generally devote more space to labor market issues than those for PRGT-supported programs, likely reflecting greater availability of labor market data, high unemployment rates, and the greater relevance of formal labor markets in these countries. Labor market issues are discussed in more detail in countries that experienced below average growth or above average unemployment, suggesting that topics are tailored to country circumstances. In many requests, however, the analysis of labor market issues appears somewhat limited. As in the case of surveillance, where labor market institutions are discussed, enhancing flexibility is a frequent theme, while concrete recommendations are less common.[23]

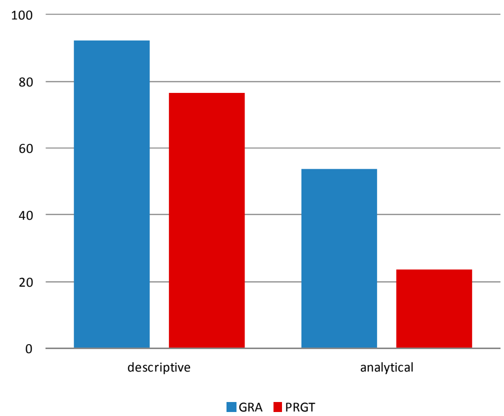
---

Solomon Islands (2011) (both APD); Bosnia and Herzegovina, Greece, Kosovo, Macedonia, Poland, Portugal, Romania, and Serbia (all EUR); Afghanistan, Georgia, Jordan, Kyrgyz Republic, and Morocco (all MCD); and Colombia, Mexico (2011), and St. Kitts and Nevis (all WHD).

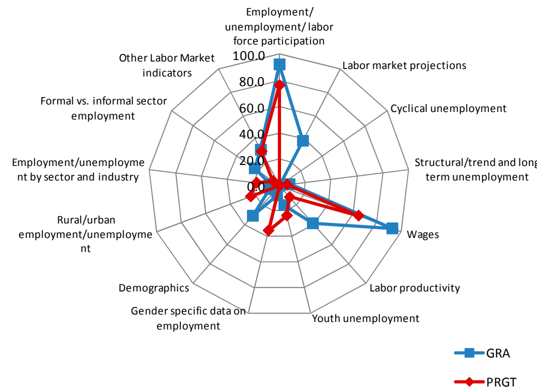
[23] The two program requests in the sample that concern member countries of the Euro area (Greece and Portugal) stand out by calling for many more flexibility enhancing measures than other requests.

## Figure 11. Stocktaking of Program Documents

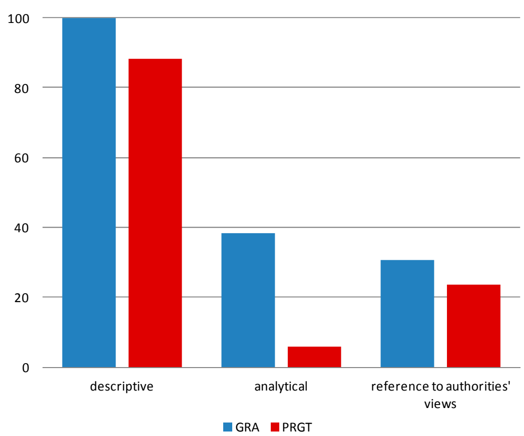
**Growth:** Most reports, and almost all GRA reports, provide descriptives of cyclical versus structural output, although fewer provide more detailed analysisi of these dimensions



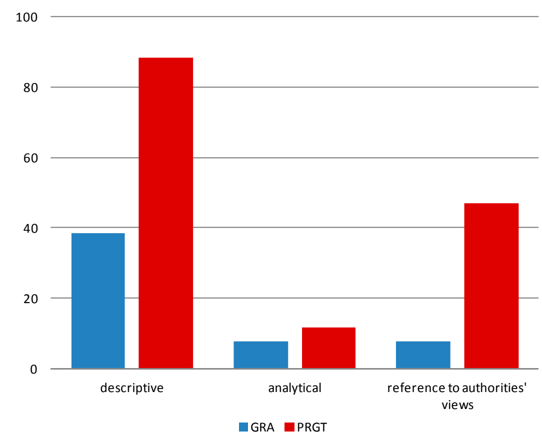

**Labor Market Topics:** Coverage varies, with most reports discussing basic indicators, such as unemployment, employment, and wages. GRA reports also cover demographics and productivity, while PRGT reports focus more on rural vs. urban employment and gender.



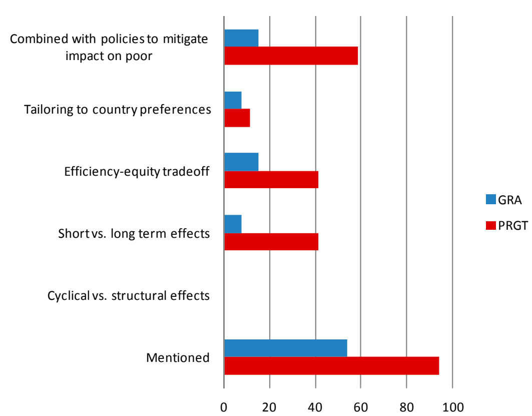

**Labor Market**: Almost always included based mostly on descriptives, with little detailed analysis (more in GRA programs) or referances to authorities views.



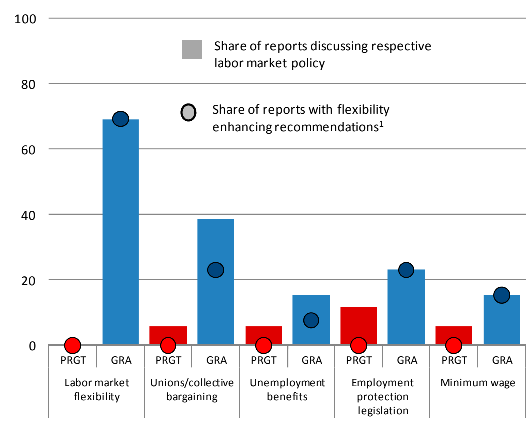

**Inclusiveness:** Often mentioned, but rarely analyzed, with more focus in PRGT program reports, including more frequent references to authorities' views.




**Impact of macro policies on labor market and inclusiveness:** Often covered, especially in PRGT programs, but tailoring to country preferences is rare. More on mitigating impact on the poor in PRGT program documents.




**Labor Market Policies:** Many references to labor market flexibility in general terms in GRA programs, but fewer specific recommendations.




[1]Less centralized/coordinated bargaining, lower unemployment benefits, less stringent employment protection legislation, lower minimum wage.

- *Inclusiveness:* The extent and character of the discussion of inclusiveness in program requests varies. In requests for PRGT-supported programs, discussion of poverty and social spending is common, in line with this program type's focus on poverty reduction, while in GRA ones, it less frequent. In particular, PRGT-supported programs often included indicative targets to monitor priority (typically, social) spending. Analysis of factors determining inclusiveness is infrequent, and reference to the authorities' views on inclusiveness is quite common in PRGT-supported programs but rare in GRA ones.

- *Impact of macroeconomic policies on labor markets and inclusiveness:* While an average of three out of four program requests refer to the impact of macroeconomic policies on labor markets or some aspect of inclusiveness, the topic is covered substantially more frequently in requests for PRGT-supported programs than in those for GRA ones. Some requests discuss the impact in more detail, including through a discussion of possible tradeoffs between equity and efficiency. In requests for PRGT-supported programs, there is also fairly frequent discussion of policy options for mitigating the impact of macroeconomic adjustment on the poor. Finally, only a small number of documents showed clear evidence of tailoring of policy advice to country preferences regarding inclusiveness or labor market reforms, although, as in surveillance, it is possible that advice was tailored without being evident in the program documents.

# VII. RECOMMENDATIONS FOR SURVEILLANCE AND PROGRAM WORK

53. **Fund advice to member countries needs to account for the megatrends of technological progress, globalization, and changing global demographics, along with the impact of the global recession**. As these trends are expected to persist (as noted above), advice needs to be tailored to promote recovery from the recession, including through aggregate demand management, and allow countries to take advantage of the opportunities that arise from the megatrends, while mitigating their adverse impacts. At the same time, the Fund needs to focus on areas within its mandate and comparative advantage vis-à-vis other international institutions.

54. **The Fund has already taken steps to help member countries face these challenges**. For example, during the early phases of the global recession, Fund advice focused on the need for coordinated global counter-cyclical fiscal and monetary stimulus. With growth remaining lackluster today, the Fund continues to support monetary stimulus and, where fiscal consolidation is warranted to anchor debt sustainability, the Fund has advised on the need for appropriate pacing—more back-loaded if financing allows, more front-loaded if under market pressure—while minimizing the burden for the most vulnerable. In developing countries, the Fund has stressed the need to protect and increase priority public expenditures, especially in education, health, and infrastructure. Regarding globalization, the Fund continues to support the multilateral trade agenda and has acknowledged that, while capital account liberalization and capital flows can have substantial benefits for countries, they also carry risks. Thus, liberalization needs to be well planned, timed, and sequenced in order to ensure that its benefits outweigh the costs (especially that countries have reached certain "thresholds" of financial and institutional development); there is no presumption that full liberalization is an appropriate goal for all countries at all times; and countries need to

manage risks associated with inflow surges and disruptive outflows (IMF, 2012e). Regarding Fund-supported programs, conditionality and design was more streamlined, adapted flexibly and appropriately to the challenges of the global financial crisis and its aftermath—including through higher and more upfront financing where needed, and increasingly emphasized macro-social aspects (IMF, 2012c).

55. **The stocktaking, nonetheless, suggests that there is room for improvement in diagnostic and policy assessments in both surveillance and program cases**. Any additional work in these areas must be consistent with the Fund's mandate (as discussed in Section VI). The following broad conclusions emerge:

- *Issues regarding growth:* Analysis of longer-term growth challenges in advanced and developing countries could be enhanced and greater country specificity introduced in policy advice.

- *Issues regarding job creation:* Labor market analysis could be strengthened by making stronger efforts to distinguish between cyclical and structural determinants of unemployment. Evidence-based advice on structural reforms and labor market policies, including advice on targeting enhanced labor force participation rates, should be focused on addressing the most binding constraints in the country and reflect more fully the current state of knowledge on the impact of labor market policies on job creation and employment outcomes

- *Issues regarding inclusiveness:* Discussion of inclusiveness could be enhanced where it is a priority. Staff could provide more discussion of the effect of proposed policies on inclusiveness, and where country authorities request, discuss policy options for enhancing inclusiveness.

56. **What follows are more detailed recommendations for enhancing the Fund work in the area of jobs and growth**.

## A. Maintain Emphasis on Macroeconomic Stability

57. **The emphasis on sound macroeconomic policies—low inflation and sustainable public finances and external positions—as the foundation for growth and jobs is crucial**. The same is true of Fund advice on structural reforms aimed at creating an enabling business and (and appropriately regulated) financial environment, establishing the rule of law, and opening up to international trade.

## B. Adapt Advice to Different Growth Challenges

58. **As noted above, different countries face different challenges**: Fund surveillance and program work should take into account these varied growth challenges. The significant amount of recent analytical work on fiscal policies could form the basis for policy advice and program design. Annex 8 discusses the role of fiscal policy in supporting growth.

- *Middle-income countries:* The challenges of middle-income countries are starting to receive some attention at the Fund but more could be done. Fund analytical work has raised awareness of the difficulties that middle-income countries face in maintaining growth over long horizons.

IMF (2012f) acknowledges that the latest slowdown in Asia could possibly reflect the middle-income trap some countries in the region are starting to face. IMF (2012a) Chapter 4 investigates growth episodes in low- and middle-income countries in recent years and documents increased growth resilience due to improved policy and lower incidence of shocks. Berg and Ostry (2011) found that a more equal income distribution can contribute to prolonging a growth spell, hence crediting effective distributive policies for helping avoid the middle-income trap. Aiyar et al. (2013) document a higher risk for a growth slowdown for middle-income countries than for other countries and identifies the macroeconomic determinants of this slowdown that are amenable to policy interventions.

- *Low-income countries, particularly in Africa:* The engagement with low-income countries on poverty reduction and growth strategies is by now a longstanding one, though more could be done on issues on sectoral transformation and reallocation that are central to growth prospects. The challenges in generating and sustaining high growth in African countries have received continued attention in Fund work, such as AFR bilateral surveillance products (e.g., IMF, 2012g) and other Fund documents including WEOs, REOs, Occasional Papers, Staff Discussion Notes and Working Papers. Discussion of these issues has focused on the factors behind growth differentials between African countries and other developing and low-income economies, as well as the drivers of growth take-offs and growth-spells. Over the most recent years, more attention has been given to the relation between growth and poverty reduction, and to the dynamics and determinants of inclusive growth (IMF, 2011a). While there is evidence that episodes of growth take-off have occurred under different sets of initial economic conditions, several factors have been typically identified as potential constraints on sustained growth, including factors related to: (i) institutions; (ii) macroeconomic, social, and political stability; (iii) trade and financial openness; (iv) education; (v) saving and private investment; and (vi) inequality. Recent evidence also suggests that several of these factors "may not now be binding constraints in Africa" (Johnson et al., 2007), and that other factors including trade and financial linkages with BRICs and structural transformation are assuming an increasingly important role (IMF, 2011b and 2012h).

- *Resource-rich developing countries:* The factors behind the relatively weak growth performance in natural resource-rich developing countries compared with non-resource-rich countries receive regular mention in Fund staff reports, and have been investigated in several other papers using case studies (e.g., Sala-i-Martin and Subramanian, 2003; Limi, 2006; and Aydin, 2011) and cross-country analysis (Arezki et al., 2011; Arezki et al., 2012; IMF, 2012i and references therein). These studies identify four main interconnected areas of interventions to support sustained development in resource-rich developing countries: (i) transforming depleting resources wealth into a portfolio of other assets, including human capital, domestic public and private capital, and foreign financial assets; (ii) avoiding boom-bust cycles that stem from volatility in natural resource prices; (iii) adapting new industrial policies to achieve diversification and economic transformation to foster job creation; and (iv) improving institutional quality and governance. A recent Fund policy paper (IMF, 2012i) contains suggestions to enhance Fund policy analysis and advice on both short-run fiscal rules to manage revenue volatility and long-term fiscal sustainability, and develops tailored new macro fiscal frameworks and policy analysis tools.

- *Fragile states:* Fragile states face particular challenges such as pervasive institutional weakness and often elevated levels of violence. A Fund policy paper (IMF, 2011c) provides suggestions for how the Fund can best assist these countries.

- *Small states:* Small states often exhibit high government wage bills, high levels of state intervention, and heavy reliance on trade tax revenues. Many of them also face slow growth and high levels of public debt. A recent Fund policy paper outlines options for helping these countries address their challenges (IMF, 2013a).

- *Countries with low labor force participation among women or other demographic groups:* In countries where the gender gap is of particular importance, the Fund can analyze the impact of low female labor force participation on economic growth, stability, and inclusion, to better inform the dialogue with the authorities about policies aimed at enhancing opportunities for women (see Annex 1 for an analysis of the gender aspects of jobs and growth).[24] For instance, the Fund can assist its members in reviewing tax codes to identify and remove provisions that discourage second earners, and could provide other policy options to boost the labor supply of women, such as child care subsidies (see also Table on p. 19). Similarly, in countries with limited opportunities for older workers, analysis could focus on developing specific incentives for the elderly to join the work force, including targeted pension reforms. More generally, Fund analysis and advice with regard to fiscal policies should where relevant take into account the potential impact of measures on under-represented groups, including women, older workers, and the young. Specifically, the Fund can assess whether tax regimes and the allocation of public resources contribute to better opportunities for these groups.

59. **Structural reforms should focus on key constraints to growth, with attention paid to any potential short-term effects.**

- *Identify key constraints to growth:* In many situations it may be helpful to identify some of the key constraints to growth, possibly in cooperation with other institutions, and focus on reforms that will remove or get around those constraints. A number of Fund country reports and papers, which have applied the Hausmann, Rodrik, and Velasco growth diagnostics framework to identify binding constraints on growth, could serve as a reference for staff that wish to undertake similar efforts. For example, Moore and Vamvakidis (2007) use the framework to examine the constraints that affect potential growth in Croatia and policies that can influence them. Lledo (2008) carries out a growth diagnostics exercise to identify governance, finance, and regulatory issues as key constraints to a thriving private sector in Mozambique, consistent with a benchmarking exercise against better-performing comparator countries. Rungcharoenkitkul (2012) combines the growth diagnostics approach with a quantitative model to identify the infrastructure gap as one of the biggest impediments to higher growth and calculate the growth dividend of its mitigation in Cambodia.

[24] As one example, in Japan, staff recommended targeted employment measures and deregulation to increase female labor force participation in order to alleviate the impact of an ageing population and a higher dependency ratio on growth and fiscal stability (IMF, 2012k).

- *Be selective with structural reforms, and take into consideration any potential short-term effects:* As noted above, the experience of countries with high and sustained growth suggests that there are a variety of ways in which reforms can be combined to deliver growth. In addition, it is advisable to exercise caution in linking projected increases in growth to specific structural reforms. Also, the Fund should assess the potential adverse short-term effects and consider how these could be countered (Box 5).

### Box 5. Fund Work on the Role of Structural Reforms in Strengthening Growth

**The role of structural reforms in boosting potential output and enhancing job creation receive regular mention in the Fund's main surveillance products, particularly for advanced economies**. For example, the Italy 2012 Article IV staff report (IMF, 2012j) discusses the role of reforms in creating the conditions needed for a solid recovery in growth and employment. These issues have been also analyzed in other Fund documents, such as WEOs, Occasional Papers, Staff Discussion Notes, and Working Papers (see Barkbu el al. (2012) and reference cited therein).

**Fund studies typically conclude that structural reforms can boost growth considerably, particularly in the medium and long run**. At the same time, several studies such as Barkbu et al. (2012) find that reforms have a small, and in some cases even negative, short-term effects on output and employment, in part because reallocating factors of production is costly and takes time. For example, Bernal-Verdugo et al. (2012) find that unemployment could increase temporarily in response to labor market reforms.

**Fund studies also conclude that structural reforms alone may not deliver a sufficient boost to short-run activity in environments characterized by high unemployment and large output gaps**, such as is the case in a number of advanced countries at this time. Recent staff estimates (Ball, Leigh, and Loungani 2013) show that the relationship between growth and unemployment has been very stable for many advanced countries since the 1980s. This suggests that at the present juncture in many advanced countries boosting output growth, through both aggregate supply and—wherever possible—aggregate demand channels, is essential to reducing unemployment in the short term.

## C. Strengthen Advice on Labor Market Policies

60. **To better integrate analysis of the business cycle and labor market outcomes, staff should strive to determine the extent to which unemployment is driven by cyclical influences and by structural factors**, as is done for output. Annex 9 provides some guidance on this issue and points to a recently developed resource staff can use. Advice on labor market policies should be explained clearly and transparently, reflect the latest state of knowledge, and be evidence based about which combinations of labor market institutions have been found to work well. The Fund should also advise on how fiscal policy can support employment growth (see Section IV), also by contributing to enhanced labor force participation of under-represented demographic groups. The Surveillance Toolkit recently developed by staff and described in Box 6 is a valuable resource for enhancing labor market and other analysis.

61. **Support labor reallocation across sectors.** Diversification in production and exports, and the reallocation of labor across sectors, are being increasingly emphasized in the literature—and, appropriately, in Fund documents as well—as essential markers of the development process. This

suggests increasing attention to policies that permit the movement of resources across sectors. "Protect workers, not jobs" is a strategy that receives wide support. In collaboration with other agencies, the Fund should thus advise countries on how to enable and support labor reallocation while protecting workers.

62. **Take greater account of the global labor market and spillovers.** The movement of jobs and people across national boundaries—reflecting the broad forces of technological change and globalization—confers long-term growth and job creation, but also creates short- and medium-run disruptions and costs that need to be managed. In the advanced economies there has been a 'hollowing out' as middle-income jobs move to emerging markets. Among the emerging economies there is increased competition for jobs in both manufacturing and service sectors. The Fund's multilateral surveillance needs to pay greater attention to the challenges facing the global labor market as a whole; to possible spillovers from one country's jobs and growth strategies; and to the multilateral consistency of the Fund's policy advice, while taking into account country circumstances.

### Box 6. Surveillance Toolkit for Jobs and Inclusive Growth

The Fund's working group on "Jobs and Growth" has compiled a toolkit designed to facilitate country teams' access to guidance notes, relevant literature, results of research projects, models, and guidance on data issues. The toolkit aims to (i) transfer 'best practices' to desk economists and improve their capacity in the areas of growth, employment, and income distribution and (ii) act as a catalytic hub for Fund staff working on these issues.

The toolkit is structured along the three pillars growth, employment, and equality and poverty. It leverages work already under way at the Fund and builds on the expertise of partner institutions, such as the World Bank, OECD, and ILO. In each of its three sections, the toolkit lists diagnostic and policy questions to help teams frame their country-specific analysis. Each of the three pillars builds on a set of modules:

- *Specific indicators.* For example, the growth section lists relevant indicators to measure different aspects of growth (such as supply and demand contributions, growth cycles, and growth potential), while the employment section includes indicators measuring employment and unemployment, wages and productivity, and institutional labor market characteristics. Different indicators measuring poverty and inequality are included in the third pillar of the toolkit.

- *Data sources.* The data sources sections of the three pillars provide links to external databases related to growth analysis; labor market and employment data; and the assessment of equality and poverty, facilitating both country-specific analysis and cross-country comparisons. (On data issues see also Annex 10 to this paper.)

- *Analytical tools.* The analytical tools provided in the three sections serve, for example, to analyze production diversification; calculate country-specific employment-growth linkages; project labor market variables; calculate poverty and inequality measures; and generate growth incidence curves.

- *Case studies and analytical papers.* The selection of papers provides examples of recent Fund work in the area of jobs and growth, papers issued by other organizations, and influential academic work on each topic.

## D. Strengthen Dialogue on Inclusiveness

63. **A lack of inclusiveness may harm macroeconomic stability and long-run growth**, as laid out in section V. The Fund should therefore continue to build its knowledge base on inclusive growth—as many departments have already been doing in recent years—and strengthen the dialogue with country authorities—and, where appropriate, with civil society organizations and other external stakeholders—on these matters. Since creating productive employment opportunities is critical to generating inclusive growth, the Fund's advice on how to strengthen growth, gear fiscal policies towards job creation, and enhance labor market institutions will be key. Continued advice on financial inclusion will also be important, particularly for developing countries. But even more can be done. In particular, the Fund should be ready to advise on how fiscal policy can be used to promote income equality while minimizing any adverse effects on growth (see Box 3).

## E. Collaborate Closely with Other Institutions in Line With Respective Mandates and Expertise

64. **The Fund should collaborate with other institutions as appropriate, in line with respective mandates and areas of expertise**. Where addressing the demand management challenges associated with the aftermath of the Great Recession is needed, the Fund with its traditional focus in macroeconomic (fiscal, monetary, and exchange rate) and financial policies has a key role to play. The Fund can advise on structural reforms in the financial sector and on fiscal policies to help boost growth. As recommended above, it can also provide fiscal policy to support employment growth and reduce income inequality where this is an objective of the authorities. Where other structural reforms to remove bottlenecks in growth or to enable deep structural change is needed, other institutions such the OECD, the World Bank, or the ILO may be better placed to advise.

## F. Provide Targeted Training and Technical Assistance

65. **Training for staff will be instrumental in mainstreaming the Fund's increased focus on jobs and growth issues**. Starting in early 2012, a number of training events have been held to bring Fund staff up to date on the latest research done at the Fund, other multilateral organizations (e.g., the World Bank, the ILO, and the OECD), and in academia. So far, this training has taken three forms:

- The Surveillance Toolkit on Growth, Employment and Inequality, developed by RES and SPR, has been disseminated to country teams through a road show to area departments.

- A dedicated seminar series, the RES/SPR Jobs and Growth Seminars, has been running since early 2012. So far, 16 events have been held, open to all staff and featuring external and internal speakers. The series will be continued and expanded in 2013 and beyond.

- The internal economics training program run by ICD is increasingly including seminars and courses on jobs and growth issues. In 2012, eight such training events were held for Fund staff featuring academics at the forefront of research on issues of growth, taxation, and inequality. These efforts will be broadened in the future, with the inclusion of various multi-day courses.

66. **Training for country officials will also help member countries move towards their goals related to growth and job creation.** ICD, in collaboration with RES, is developing a new course for government officials that will focus on how the instruments of macroeconomic policy making (taxes, subsidies, composition of expenditure in certain circumstances) interact with the considerations of growth and equity. This course will also form the basis for new internal training on jobs and growth. Some internal courses and seminars on jobs and growth issues could also be opened to government officials in line with usual practice.

67. **The Fund will continue to provide technical assistance to member countries to enhance fiscal performance and strengthen fiscal institutions, both of which help foster inclusive growth**. In fiscal year 2013, the Fiscal Affairs Department (FAD) is providing about 280 missions. This includes technical assistance on tax policy to enhance the efficiency, fairness, and productivity of tax systems; revenue administration to help countries raise tax receipts at a low administrative cost; public financial management to ensure effective delivery of intended budgetary policies and improve transparency; and expenditure policy on pension reform and options to rationalize spending in the short-term by reducing unproductive spending (such as energy subsidies) while protecting the poor through better targeting of social benefits. Technical assistance includes missions from headquarters and stand-alone (long-term, short-term, and peripatetic) expert assignments that assist countries in implementing headquarters mission recommendations. Technical assistance is also provided through a network of eight Regional Technical Assistance Centers (RTACs) covering 90 countries in the Pacific; the Caribbean; East, West, Central and Southern Africa; the Middle East; and Central America. The RTACs provide assistance to support implementation of reforms proposed by missions from headquarters. The Fund also provides substantial technical assistance to help countries strengthen their financial systems. This will help countries strengthen growth and enhance financial inclusion.

## G. Sustain Outreach and Communication on Jobs and Growth Issues

68. **Over the past decade, the Fund has become progressively more engaged with external stakeholders on jobs and growth issues**. Fund management and staff have been part of this dialogue through various efforts including: speeches, participation in conferences, seminars at the Fund's Spring and Annual Meetings, blogs, and various publications (such as *Fostering Growth in Europe Now*, and *Fiscal Policy and Employment in Advanced and Emerging Economies*). The team preparing this report also consulted extensively with a panel of experts in the preparation of the report, and have incorporated their views to the extent possible (Annex 11). There have been efforts to reach out to other institutions in the context of analytical work, resulting in a study of the effects of policy reforms on employment prepared jointly with the ILO, the World Bank, and the OECD. Fund-ILO cooperation took on greater prominence following the 2010 Oslo Conference on Growth, Employment, and Social Cohesion. This work has included a pilot IMF-ILO social dialogue effort—country-focused consultations with the authorities, labor, and business on employment-related issues—as well as collaboration with the ILO on the design of social protection floors. Pilot social dialogue consultations have taken place in three countries (Dominican Republic. Bulgaria, and Zambia) and six other countries (El Salvador, Mozambique, Vietnam, Benin, Cambodia, and Nepal) are involved in the pilot effort to design social protection floors. Fund engagement with labor

unions has also gained considerable momentum in recent years, taking place at the international and national level, with cooperation centered on the International Trade Union Confederation (ITUC). Formal interaction with the labor movement began in 2002 with the establishment of a mechanism for annual dialogues with the ITUC's predecessor confederations and the World Bank, called the High-Level Meetings (HLMs). The HLMs have taken place about every two years, with the most recent held in February 2013. Interactions with national unions have also increased, including by Fund management and country teams in the context of bilateral surveillance and program engagements. Further, to ensure a two-way flow of information, an Advisory Group that includes representatives from academia, labor unions, and other international financial institutions has been created and has provided valuable suggestions for taking forward the Fund's work on jobs and growth.

69. **Sustained efforts are needed to make stakeholders and the general public aware of the Fund's efforts to help countries reach the jobs and growth outcomes they desire, as well as to enable the Fund to keep learning from the perspectives of external partners**. While this paper provides a snapshot of the current situation, regular dialogue can provide important inputs to a process of continuously re-evaluating the Fund's contribution, and thereby identifying areas for improvement. In this context, it remains important to maintain and strengthen the ongoing dialogue with other IFIs and social partners, including labor unions, the business community, civil society organizations, academia, and the public at large.

## H. Resource Needs

70. **Staff's work on the jobs and growth agenda thus far has been accomplished within the existing resource envelope**. Staff time and other costs associated with the agenda—producing the analytic output of the working group, the development of the "Jobs and Growth" surveillance toolkit, the template for analyzing and forecasting labor market indicators, the seminar series, and the pilot programs with the ILO on social dialogue and social protection—have all been met by the main departments through reallocation of resources from other tasks.

71. **Although the resource costs of our recommendations for future work are not large, it would be good to provide a secure basis for funding them**. As discussed in the sections on stocktaking, a substantial amount of work on jobs and growth issues is already being done at the Fund. This includes analytical work, multilateral surveillance, and work by country teams in the context of bilateral surveillance and program engagements. The recommendations made above largely suggest some refocusing of this work rather than a large amount of additional work. There is also scope for the Fund to better leverage work done outside the institution, including through closer collaboration with the other multilateral institutions on issues where they have expertise. Nevertheless, some centralized funding would be essential to provide staff with the 'public goods' associated with the agenda. Some of these include: (i) continuation of projects—in collaboration with the ILO, World Bank, and external experts—to fill gaps in data and analysis of labor market indicators, particularly for emerging markets and developing countries; (ii) maintenance and further development of the "Jobs and Growth" surveillance toolkit so that it remains an up-to-date resource for staff; (iii) refinement of the template for projecting labor market indicators in response to

comments received at presentations at the ILO, the European Commission, and other venues; and (iv) continuation of the "Jobs and Growth" seminar series, which has proved to be a cost-effective means of promoting dialogue within the Fund on these issues. The costs of these activities are modest and seem like a good investment for the Fund to make given the importance authorities attach to attaining the goals of job creation and inclusive growth and the findings of the TSR that discussion of these issues with the authorities is a way to gain traction.

# Annex 1. Gender Aspects of Jobs and Growth

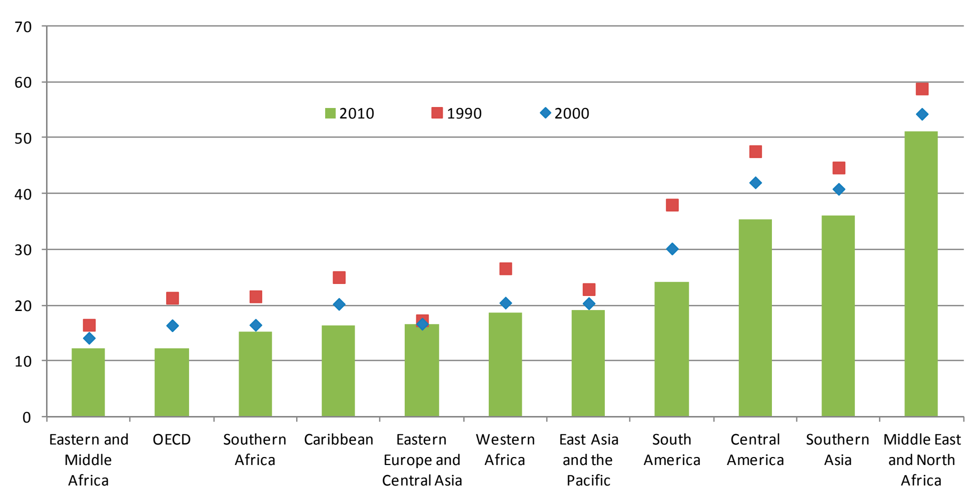
*Labor markets and access to economic opportunities across the globe are often segregated along gender lines. Despite some progress in recent decades, female labor market participation has remained persistently lower than male participation, women account for most unpaid work, and, when paid, face significant wage differentials vis-à-vis their male colleagues, often in spite of equal or higher education levels. The career patterns of women differ substantially from those for men, and in most countries, senior positions in both the private and the public sectors remain a largely male domain. To unleash the full potential of the female labor force, with significant prospective growth implications, policy makers need to pursue an integrated set of policies to promote and support female employment.*

## Female Labor Force Participation

1. **Despite a modest increase in women's share of the global labor force and a narrowing of gender gaps in participation rates in a number of countries, average female labor force participation remains low at around 50 percent.** Between 1980 and 2008, the global female Labor Force Participation Rate (LFPR) increased slightly from 50 to 52 percent, and by 2008 women accounted for more than 40 percent of the global labor force. During this period, the gender gap, the difference between male and female labor force participation, narrowed from 32 to 26 percentage points, largely owing to declines in male participation rates, but with wide variations between regions (World Bank 2011; and OECD 2012).

**Gender Gap in Labor Force Participation, 1990 to 2010**

(Male Minus Female Labor Force Participation Rates, in Percentage Points)

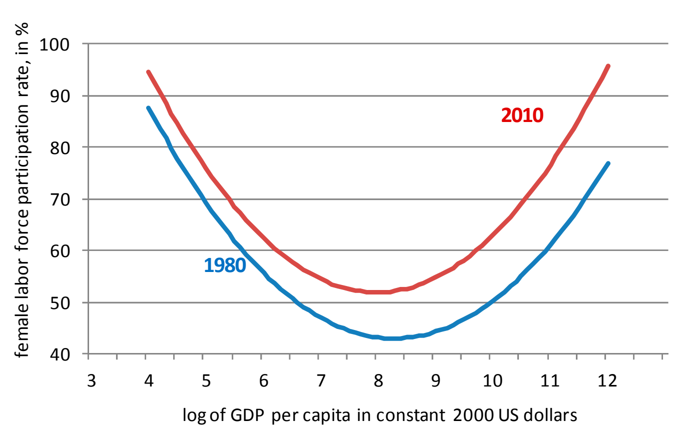



*Source: Key Indicators of the Labour Market (KILM), ILO.*
Country groups are based on UN Geoscheme (using Wikipedia) and WB regional classification.

2. **The female LFPR and the gender gap in participation rates vary considerably among regions and countries**. The female LFPR ranges from 26 percent in the MENA region and 35 percent in South Asia to more than 60 percent in East Asia and the Pacific and Sub-Saharan Africa, and even higher levels in many advanced economies (World Bank 2011). As for the gender gap, within the OECD, it ranges from 6 percentage points in Sweden to 25 percentage points in Japan, averaging 10 percentage points. Gender gaps are much higher in MENA and South Asia (40-50 percentage points) and have narrowed very little over the past two decades. Possible explanations for the low female LFPR in the MENA and South Asia include limited private sector employment opportunities for women, relatively high income levels for the male workforce, gender-specific taxation, and societal norms (World Bank 2011; Tsani 2012; and Laframboise and Trumbic 2003).

3. **The female LFPR also varies with the level of per capita income**, with empirical evidence pointing to a U-shaped relationship. At lower levels of per-capita income, a high female LFPR reflects women's agricultural work and the necessity to work in the absence of income protection. When economic development results in higher household income, the withdrawal of female labor supply from the market in favor of household work or childcare becomes an economically viable option. At developed country income levels, labor force participation increases again as a result of higher female education rates, lower fertility rates, the removal of barriers to female work, development of household technology, and market-based household services. (Duflo 2011; and Tsani 2012) The U-shaped LFPR curve was found to move upward over time, reflecting changes in education and family structure (World Bank 2011).

**Female Labor Force Participation, 1980 and 2000**




*Sources: WDI; Key Indicators Labor Market (KILM), ILO.*

## Gender-Specific Labor Market Characteristics

4. **While gender issues in labor markets are often discussed in terms of LFPR, there are many other gender-specific characteristics**. For instance, women's ability to participate in the labor market is constrained by their considerably higher allocation of time to unpaid housework and child care. In advanced economies, gender-specific career paths, characterized by more part-time

work and career breaks for child care, result in a higher risk for old-age poverty among women as a result of lower contributions to pension plans (Duflo 2011; and OECD 2012).

5. **In many developing countries, women dominate the informal sector**, characterized by vulnerability in employment status, a low degree of protection, mostly unskilled work, and low earnings stability (Campbell and Ahmed 2012). In agriculture, particularly in Africa, women operate smaller plots of land and farm less remunerative crops than men (World Bank 2011).

6. **Legislation and social norms also determine women's participation in market work and entrepreneurship**. In many countries, legislation constrains women's employment, rights to land ownership and inheritance, and their access to credit, while societal norms with regard to women's independent mobility limit their ability to work outside the home (UN and ILO 2012; and Duflo 2011).

7. **There is a considerable wage gap associated with gender, even controlling for occupation and individual characteristics, such as education**. Across OECD countries, the gender wage gap is estimated at 16 percent, being even higher in self-employment. While narrow for young women, the wage gap increases steeply during childbearing and childrearing years, pointing to a "motherhood penalty" that reaches 14 percent across the OECD (OECD 2012).

8. **Income tax regimes often constitute a disincentive to female labor force participation, as they impose a penalty on second earners, in most cases married women**. By taxing family income rather than individual income, the resulting higher marginal tax rate on the second income reduces the incentives for women to join the labor force (IMF, 2012j). For the OECD membership, Jaumotte (2003) finds that secondary earner's tax wedge affects female labor market participation negatively.

### Did the Economic Crisis have a Gender-Specific Impact?

9. **During the economic downturn of 2007-09, gender employment gaps shrank in most OECD countries**, largely explained by more robust employment in the services sector, compared to male-dominated industries such as construction and manufacturing. However, the pattern changed between 2009 and 2011-12, when female unemployment continued to rise, while unemployment among men either declined or slowed down (Kochhar 2011; and OECD 2012).

10. **In many developing countries, women and girls were particularly vulnerable to the effects of the economic crisis**. This often resulted in a disproportional decline in primary school completion rates for girls and higher vulnerability for women and girls to risky and unprotected informal sector employment (Stavropoulou and Jones 2013).

### Does Gender Matter?

11. **The misallocation of women's labor as a result of discrimination, social norms, or lack of opportunity results in economic losses** (Stotsky 2006). Based on ILO data, Aguirre et al. (2012) estimates that worldwide, 865 million women have the potential to contribute more fully to their

national economies, out of whom 812 million live in emerging and developing nations. For Japan, Steinberg and Nakane (2012) posit that raising the female LFPR could reduce the dependency ratio and slow the steady decline in Japan's potential growth rate resulting from an aging population. Japan's annual potential growth rate could rise for some time by about ¼ percentage point if the female LFPR was to move to the G7 average, resulting in a permanent rise in per capita GDP of 4 percent, compared to the baseline scenario (IMF, 2012k; and Matsui 2010).

12. **Women have demonstrated a stronger preference for expenditure on child welfare than men**. Accordingly, better opportunities for women could be an important contributing factor to broader economic development in poor countries, for instance through higher school enrollment for girls (Aguirre et al, 2012; Evangelista and Filho 2008; and Duflo 2000). However, while the relationship between gender equality and growth is often assumed to be positive, more research will be needed to prove its robustness and determine causality (Duflo 2011).

13. **The employment of women on an equal basis would allow companies to make full use of the available talent pool**, possibly improving their performance and their ability to serve consumer markets dominated by women (Barsh and Yee 2012; Dezso and Ross 2011; and OECD 2012).

### Policy Measures in Support of Female Labor Market Participation

14. **Policymakers need to distinguish between cyclical and structural challenges to female employment**, with cyclical measures to foster female employment corresponding closely to policies in support of overall higher employment. These include, for instance, fiscal stimuli; work-sharing arrangements; and ALMPs supporting job search assistance and training for jobseekers (World Bank 2011; and World Bank 2012).

15. **At the structural level, an integrated set of policies to promote and support female employment will be essential**. The specific policy responses required to achieve significant change depend on the level of economic development, and gender-neutral measures could have a disproportionally large positive effect on women if they alleviate gender-specific constraints (World Bank 2011; and Duflo 2011). In many countries, a change in social norms will be needed in order to free up women's time for paid employment and allow women to assume more high-level responsibility in the public and private sectors (Barsh and Yee 2012; and CED 2012).

16. **For countries at all income levels policy measures should include a review of tax codes in order to identify and remove provisions that discriminate against second earners**. For example, in Japan, staff recommended targeted employment measures and deregulation to increase female labor force participation in order to alleviate the impact of an ageing population and a higher dependency ratio on growth and fiscal stability (IMF, 2012k). Tsounta (2006) posits that the decrease in the secondary earner's tax wedge contributed significantly to the increase in Canadian women's LFPR between 1995 and 2001. In order to establish additional incentives for partners to join the labor force, special tax relief could be targeted to secondary earners or single parents.

Medical aid plans, medical insurance plans, and pension systems should also be scrutinized for explicit or implicit gender bias (Steinberg and Nakane 2012).

17. **In developing and emerging economies, policies should target**:

- Labor legislation and social norms that allow women to fully participate in the labor market. For instance, the removal of a ban on part-time work in Argentina triggered a shift from informal sector to formal sector part-time work among mothers (World Bank 2011). The analysis of labor market disparities in Saudi Arabia highlighted possible measures to address the gender balance, through more wide-spread work from a distance and female employment in food-processing industries and in retail targeting female customers (IMF, 2012l).

- Gender parity in access to health services, school education, and vocational training to help women transition from informal to formal sector work.

- The removal of poverty traps through better access to infrastructure, transport, and child care, in order to free up women's work time and improve welfare, equality and inclusion. Electrification in rural South Africa was found to have increased women's labor market participation. In Mexico, the federal daycare program for working mothers has facilitated formal employment of low-income mothers (UN and ILO 2012).

- Equal rights for women in property ownership, entrepreneurship, family law, and inheritance legislation.

18. **In advanced economies, policy makers should focus on**:

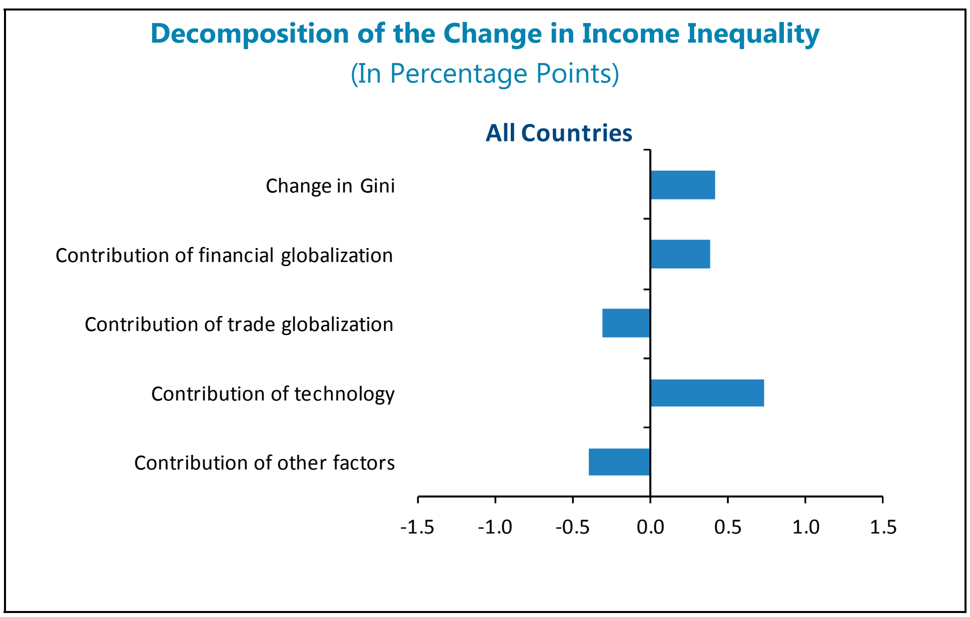
- Access-to-work policies, such as non-discrimination policies, access to flexible work arrangements, and facilitating the transition from part-time work to full-time work. For instance, in the Netherlands, the rapid increase in female LFPRs was the result of a break-down in barriers between full-time and part-time work contracts in the early 1980s (Steinberg and Nakane 2012).

- Enhanced parental leave benefits and better access to comprehensive, affordable child care. For example, Sweden's high female LFPR is mostly attributed to a generous and flexible parental leave policy with a high coverage rate of child care, job guarantee, and eligibility for reduced working hours.

# Annex 2. Impact of Technological Change and Globalization on Inequality

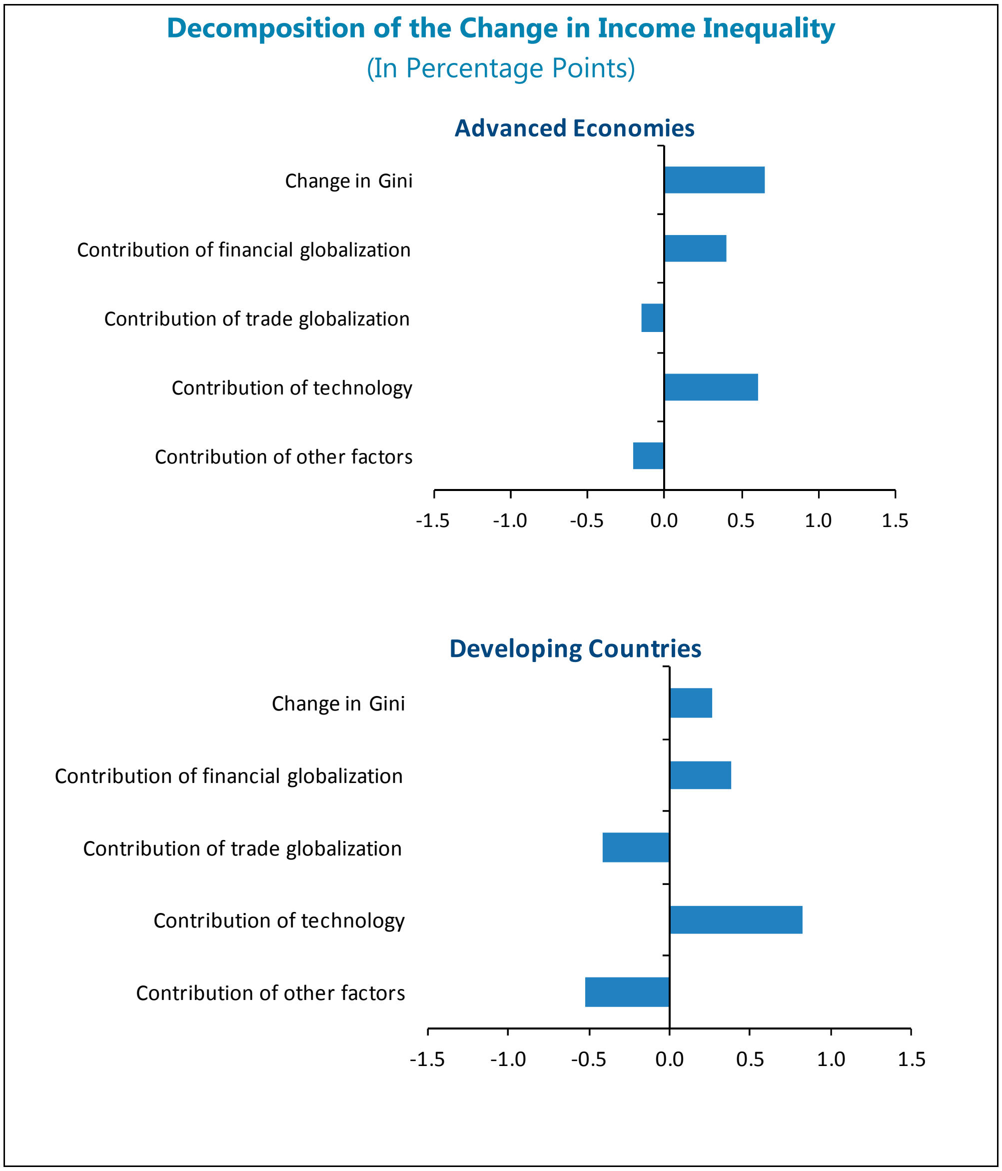
1. **Technological progress and globalization are generally accepted as the drivers of economic growth**. The development of new ideas that enhance productivity and the diffusion of these ideas around the globe have raised average living standards. These trends also have distributional effects, however, which remain a matter of debate. Recent work by staff (Jaumotte, Lall, and Papageorgiou, 2012) finds significant effects of technology and globalization—both trade and financial globalization—on inequality in a large panel of countries over the past decades. Some observers also point out that shifts in social norms since the 1980s and changes in institutions, e.g. decline in the role of labor unions, have coincided with this increase in inequality.

2. **The analysis relates the Gini coefficient, a commonly-used measure of inequality, to various measures of globalization and a measure of technological change**, while controlling for other factors such as educational attainment and access, sectoral composition of employment, and the level of domestic financial development. Technological change is measured by the share of information and communications technology (ICT) capital in the total capital stock. The globalization measures distinguish between trade and financial openness. Specifically, trade openness is measured by the average tariff rate (de jure measure), and the ratios of trade to GDP (de facto measure). Financial globalization is measured by an index of capital account openness (de jure measure) and the ratios of various types of financial liabilities and assets to GDP (de facto measures).




3. **As shown in the figure above, for a sample of 51 countries over the period 1981-2003, there was an annual increase in the Gini coefficient of about 0.4 percent**. Technology and globalization added about 0.8 percentage points to inequality, but 0.4 percentage points of this was offset by increase in education and changes in the sectoral composition of employment. The small net impact of globalization on inequality, however, conceals an important finding: the impacts of

trade and financial globalization work in opposite directions. Trade liberalization and export growth are associated with lower income inequality, while increased financial openness is associated with higher inequality.




4. **In both advanced and developing countries, financial globalization—and FDI in particular—are associated with increases in income inequality**. The distributional impacts of financial globalization and technological progress both appear to be working by increasing the premium on higher skills and possibly higher returns to capital. This view is supported by a look at the sectoral composition of FDI, which suggests that FDI mostly takes place in relatively higher skill- and technology-intensive sectors, and thereby increases the demand for more skilled workers.

5. **To gain further insight into the impact of globalization on inequality, the model was also estimated using the income shares of the five quintiles of the population as dependent variables**. Interestingly, the effects on the bottom four quintiles are qualitatively similar and in the opposite direction from that of the richest quintile. Export growth is associated with a rise in the income shares of the bottom four quintiles and a decrease in the share of the richest quintile. In contrast, financial globalization, and technological progress are shown to benefit mainly the richest 20 percent of the population.

# Annex 3. Growth Strategies: What Works, What Doesn't

## What Works: Conclusions of the Commission on Growth and Development

1. **The Growth Commission drew inspiration from economies that had sustained growth of 7 percent or more, for 25 years or longer, quintupling in size in the space of a generation**. It attempted to demystify these economic "miracles," identifying characteristics they all shared. Five of these common features are described below.

- These economies fully exploited the world economy. They imported ideas, know how, and technology from the rest of the world. At the same time, they produced goods that met global demand, allowing them to specialize and expand rapidly without saturating the market.

- They maintained macroeconomic stability. They kept a grip on inflation and did not stray down unsustainable fiscal paths.

- They achieved high rates of investment, including public investment, financed by equally impressive rates of domestic saving.

- In allocating resources, these economies paid due respect to market signals. This deference to the market was not absolute: in some cases, governments bent the law of comparative advantage, by favoring some industries over others. But even in these cases, the favored industries had to pass a market test by successfully exporting their products to foreign customers. And when the market gave its verdict, these economies were able to respond. Labor was relatively mobile, and stagnant industries were allowed to fail, creating space for more promising rival ventures. Governments recognized their duty to protect laid-off workers from economic misfortune. But they felt no obligation to preserve unviable industries, companies, or jobs.

- As a complement to these functioning markets, the successful economies also had committed, credible, and capable governments. While market incentives and entrepreneurial dynamism are the proximate drivers of growth, governments cannot be written out of the script. Their macroeconomic strategies and microeconomic regulations provide the setting in which market dynamics can work. Governments must also furnish a range of public goods, such as schooling and infant nutrition, that the market may under-provide. In the successful countries, governments showed great perseverance in their pursuit of growth, experimenting with different country-specific growth strategies, and abandoning strategies that had outlived their usefulness, despite the upheaval this often entailed. They offered a credible vision of the future that justified sacrifices today in the expectation of rewards tomorrow. And they tried to distribute these rewards quite widely. They promoted equal opportunities as far as possible and narrowed unequal outcomes, not least because gross inequality can threaten the legitimacy of a growth strategy. The somewhat chaotic microeconomics of structural transformation can create hardship and a skewed pattern of burdens and rewards. In successful growth strategies, the government works hard to ameliorate both.

- These characteristics are relatively easy to identify. It is harder to know how to replicate them in new places and new circumstances. The Growth Commission Report laid out a number of reforms, policies, and other ingredients of a successful growth strategy, but warned that the specific "recipe" that weighs and mixes these ingredients will differ from country to country, as well as evolve over time. Economic development is a decades-long process, which requires a long time horizon and a measure of persistence to circumvent the roadblocks that inevitably emerge along the way.

## "Bad Ideas" according to the Commission on Growth and Development

2. **"An illustrative list of "bad ideas," which are nonetheless often brought into the debate and should be resisted, is offered below**. We hasten to add that just as our recommendations for good policies are qualified by the need to avoid one-size-fits-all approaches and to tailor the policies to country-specific circumstances, our list of bad policies must also similarly be qualified. There are situations and circumstances that may justify limited or temporary resort to some of the policies listed below, but the overwhelming weight of evidence suggests that such policies involve large costs and their stated objectives—which are often admirable—are usually much better served through other means.

- Subsidizing energy except for very limited subsidies targeted at highly vulnerable sections of the population.

- Dealing with joblessness by relying on the civil service as an "employer of last resort." This is distinct from public-works programs, such as rural employment schemes, which can provide a valuable social safety net.

- Reducing fiscal deficits, because of short term macroeconomic compulsions, by cutting expenditure on infrastructure investment (or other public spending that yields large social returns in the long run).

- Providing open-ended protection of specific sectors, industries, firms, and jobs from competition. Where support is necessary, it should be for a limited period, with a clear strategy for moving to a self-supporting structure.

- Imposing price controls to stem inflation, which is much better handled through other macroeconomic policies.

- Banning exports for long periods of time to keep domestic prices low for consumers at the expense of producers.

- Resisting urbanization and as a consequence underinvesting in urban infrastructure.

- Ignoring environmental issues in the early stages of growth on the grounds that they are an "unaffordable luxury."

- Measuring educational progress solely by the construction of school infrastructure or even by higher enrollments, instead of focusing on the extent of learning and quality of education.

- Underpaying civil servants (including teachers) relative to what the market would provide for comparable skills and combining this with promotion by seniority instead of evolving credible methods of measuring performance of civil servants and rewarding it.

- Poor regulation of the banking system combined with excessive direct control and interference. In general, this prevents the development of an efficient system of financial intermediation that has higher costs in terms of productivity.

- Allowing the exchange rate to appreciate excessively before the economy is ready for the transition towards higher-productivity industry."

## Strategies for Countries with Particular Challenges

3. **Middle-income countries**: Policymakers should anticipate the transition from a low-wage economy with infinitely elastic labor supply to a higher-wage economy, constraining the growth in labor-intensive sectors and possibly causing shortages of high-skilled labor. Correctly-timed policies will support the shift to a knowledge- and capital-intensive economy, accompanied by a reduced role for public planning processes, in favor of market-determined decision making. In particular, structural change will require the phasing out of specific industrial policies, such as special export zones and heavily managed exchange rates.

4. **Low-income countries in Sub-Saharan Africa**: Policymakers should promote integration with the global economy; densification of people and economic activities; and reliance on comparative advantage. Infrastructure development, supported by regional cooperation, is needed to enhance agricultural productivity, export diversification, and trade in services. Higher school enrollment will support the quality and the output of skills. Access to financial services and formalized property rights are critical for developing entrepreneurial activity and the scaling-up of successful businesses, and improved government administration will reduce the overall cost of doing business. Advanced economies can support African growth strategies through better targeted aid; time-bound trade preferences for manufactured exports; support for tertiary education to compensate for the brain drain; and peacekeeping in fragile and post-conflict countries.

5. **Resource-rich economies**: Policymakers should be aware of the critical importance of decisions on the allocation of exploration rights and be mindful of the role of taxes in determining the flow of rents. Where appropriate, policy makers should consider the option of renegotiating concessions to restore the balance between private return and public revenue. Decisions on the use of revenues from resource flows will have to take into account growth-promoting public investment needs, in particular in education, technology, and infrastructure. Revenues in excess of public investment needs should flow into a wealth fund that is insulated from political pressures and managed by experienced investment professionals operating within well-defined parameters. In the interest of equity and inclusion, wealth funds should pay out a certain percentage of total wealth

each year for the benefit of the population. Policymakers' adherence to the principles of the Extractive Industries Transparency Initiative will support the transparency framework of resource-rich economies.

6. **Small states**: Strategies to overcome the specific economic challenges of small states include the pooling of markets through regional economic integration, also building on the opportunities created by tradable information and communication technology services. Enhanced regional integration could facilitate the sharing of key government services to reduce the high per capita costs of government, for example, through multi-country central banking (as in Central and West Africa); a joint telecommunications authority (as in the Eastern Caribbean); and a joint Supreme Court (as established by six independent states and three British Overseas Territories in the Caribbean). Developed countries can assist small states with insurance products that alleviate the high risk of weather-related economic losses, and by taking into the account their specific needs at the World Trade Organization and other international organizations.

# Annex 4. World Development Report on Jobs: Main Findings

1. **"Moving jobs center stage."** "Development happens through jobs." However, some jobs "do more for development" and development strategies should therefore facilitate the creation of jobs with the highest payoffs, given country circumstances.

2. **The world of work is diverse, changing, and powered by the private sector**. Most jobs in developing countries are not in paid employment, with significant variation across countries. Demographic shifts (large cohorts entering labor markets), structural transformations (towards cities and more services employment), technological progress (resulting in production/trade in tasks and higher demand for skills), and macroeconomic crises (increasing unemployment) result in diverse jobs challenges. The solution "rests with the private sector" where most jobs are created.

3. **Jobs can boost living standards, raise productivity, and foster social cohesion**. Jobs are the most important determinant of living standards, with most exits from poverty related to labor events and increase in labor earnings contributing most to poverty reduction. Growth happens as existing jobs become more productive and workers reallocate to more productive jobs, often in larger firms (many people in developing countries work in smaller, less productive enterprises that are less likely to grow). "Jobs are who we are" and lack of job opportunities for all can contribute to unrest.

4. **Some jobs do more for development than others**. Jobs that generate positive spillovers have greater value to the society through (1) higher living standards (these include jobs for the poor, jobs that empower women, and jobs that do not shift burden to others); (2) productivity (jobs that are environmentally benign, connected to world markets, and in functional cities); and (3) social cohesion (jobs that give a sense of fairness, provide networks, and shape values and behaviors).

5. **Job challenges are diverse.** Jobs challenges vary across countries, shaped by their level of development, demography, natural endowments, and institutions. There are eight clusters of developing countries that face similar challenges.

- *Challenges based on level of development:*

  - *Agrarian*: Raising productivity in agriculture, while encouraging policies that will, over time, make cities more functional and able to reap benefits from agglomeration and global integration.

  - *Urbanizing*: Deepening global integration, particularly in higher-value-added export sectors.

  - *Formalizing*: Raising formal sector employment to levels typical of industrial countries involves trade-offs between living standards, productivity, and social cohesion.

- *Challenges based on demographic structure:*

  - *High youth unemployment*: Raising competition in the private sector by removing privilege in business entry and access to jobs.

  - *Aging societies*: Containing increase in pension, health care, and long-term care costs, while minimizing the social strain of these reforms.

- *Challenges based on natural endowments and other conditions:*

  - *Natural resource-rich*: Creating employment when exploitation of natural resources is a source of wealth but not labor intensive.

  - *Small islands*: Creating employment opportunities outside basic services and government.

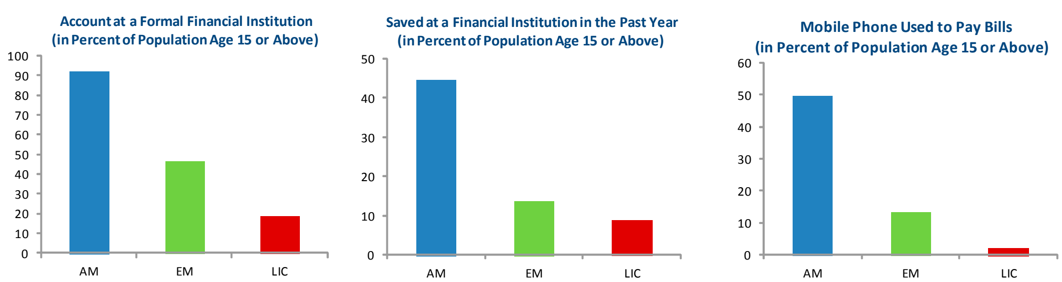
  - *Conflict-affected*: Providing employment opportunities to support social cohesion.

# Annex 5. Role of the Financial Sector in Supporting Inclusive Growth

1. **More varied and accessible financial services not only boost overall growth, but also reduce poverty and inequality**. Financial systems serve a vital purpose, offering savings, credit, payment, and risk management products to people with a wide range of needs. Without inclusive financial systems, individuals must rely on their limited savings to invest in their education or become entrepreneurs, and small enterprises must rely on their limited earnings to pursue growth opportunities. This can contribute to persistent income inequality and slower economic growth. A well-developed financial system can allow a society to invest in more productive projects, promoting diversification and dampening cyclical fluctuations (Acemoglu and Zilibotti, 1997). Better and cheaper services for saving money and making payments and access to insurance products also allow poor households to avoid the cost of barter or cash transactions, cut the costs of remitting funds, and provide the opportunity to accumulate assets and smooth income against shocks.

2. **While the financial sector has gradually broadened in developing countries, financial inclusion remains limited**. The domestic credit the private sector receives as a percent of GDP varies from around 30 percent in low-income countries (LICs) to 83 percent in emerging markets (EMs). Even though the share has been increasing since 2000 for all country income levels, developing countries still lag behind high-income countries (International Finance Corporation (IFC), 2013). This is also reflected in their more limited access to finance. While 92 percent of adults in advanced market economies (AMs) report that they have an account at a formal financial institution, it is only about 47 percent in EMs and less than 19 percent in LICs. High-income countries have on average 12 times more bank branches per 100,000 adults than the average LIC—and 30 times more automated teller machines (Jahan and McDonald, 2011). Still, access to financial services—through mobile banking and micro-finance—is growing rapidly in many developing countries.

**Indicators of Financial Inclusion**




*Source: World Bank The Global Financial Inclusion (Global Findex) Database; IMF staff calculation.*

3. **Access to funding and financial services is critical to ensure that entrepreneurship can thrive and drive employment opportunities**. Lack of access to finance is a key constraint to job creation, particularly for small and medium enterprises (SMEs) in developing countries which tend to be more labor intensive than large firms. The World Bank estimates that 45-55 percent of formal SMEs in developing countries are not effectively covered by any commercial banking institutions

while over 20 percent face financing constraints (IFC, 2010). Studies have shown that access to finance has the largest employment effects for SMEs, which are also the most credit constrained. SMEs also face relatively higher costs to enter capital markets than do larger firms, due to their higher credit risk and smaller financial needs. Yet studies have found that firms supported by private equity achieved higher employment than those that did not have private equity financing (IFC, 2013).

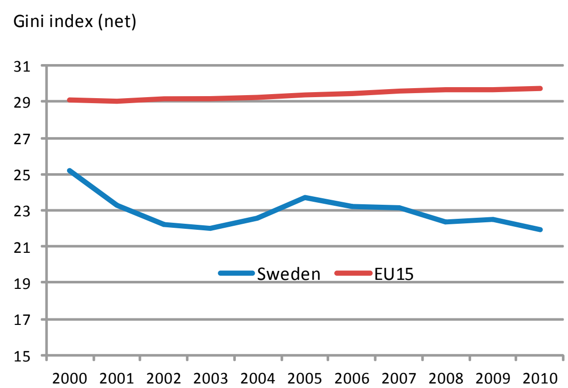
4. **Considerable heterogeneity across developing country financial systems argues for different areas and approaches for promoting inclusive financial systems**. Lessons from cross-country experiences suggest that targeted and balanced initiatives to encourage competition, develop information and market infrastructure, address collateral issues, and limit excessively intrusive public sector interventions and dominance, can lower the costs and risks of expanding access to financial services (IMF, 2012m). Promoting financial education and consumer protection are a priority in the context of the growth of consumer finance, such as the introduction of new financial tools and products to new consumers (including credit cards, pensions, mortgages, and micro-loans).

# Annex 6. Growth with Equity—The Cases of Sweden and Brazil

## Sweden

1. **Over the past two decades, Sweden has had robust growth and declining trend unemployment**. GDP growth between 1993 and 2010 averaged 2½ percent per year and productivity growth 2 percent per year, compared with 2 percent and 1 percent respectively for the other European Union 15 (EU15) countries. Sweden also recovered from the global financial crisis faster than other EU15 countries.

**Sweden and EU15: Gini Index, 2000-2010**




*Source: Standardized World Income Inequality Database (2011)*

2. **The improvement in living standards has been accompanied by equality of opportunities and income, and lower poverty both in absolute and relative terms**. During the last decade Sweden's inequality (proxied by the Gini coefficient for disposable income) has declined from about 25 to 22, while it has increased slightly in the other EU15 countries.

3. **In addition, Sweden ranks high in indicators of the quality of life and for its business environment**. One list ranked it first among countries based on its average score on a variety of indicators.

| Overall rank* | Country | Global competitiveness | Ease of doing business | Global innovation | Corruption perceptions | Human development | Prosperity |
|---|---|---|---|---|---|---|---|
| 1 | Sweden | 4 | 13 | 2 | 4 | 10 | 3 |
| 2 | Denmark | 12 | 5 | 7 | 1 | 16 | 2 |
| 3 | Finland | 3 | 11 | 4 | 1 | 22 | 7 |
| 4 | Norway | 15 | 6 | 14 | 7 | 1 | 1 |
| 5 | Switzerland | 1 | 28 | 1 | 6 | 11 | 9 |
| 6 | New Zealand | 23 | 3 | 13 | 1 | 5 | 5 |
| 7 | Signapore | 2 | 1 | 3 | 5 | 26 | 19 |
| 8 | United States | 7 | 4 | 10 | 19 | 4 | 12 |
| 9 | Netherlands | 5 | 31 | 6 | 9 | 3 | 8 |
| 10 | Canada | 14 | 17 | 12 | 9 | 6 | 6 |

Sources: World Economic Forum; World Bank; INSEAD and World Intellectual Property Organization; Transparency International; UNDP; Legatum.
*Based on equal weighting of indices.

4. **These distributional outcomes have been achieved thanks to a range of policies including**:

- Regulations and other interventions aimed at supporting market incomes of lower-paid workers, including wage compression and support of work-related expenditures, notably childcare.

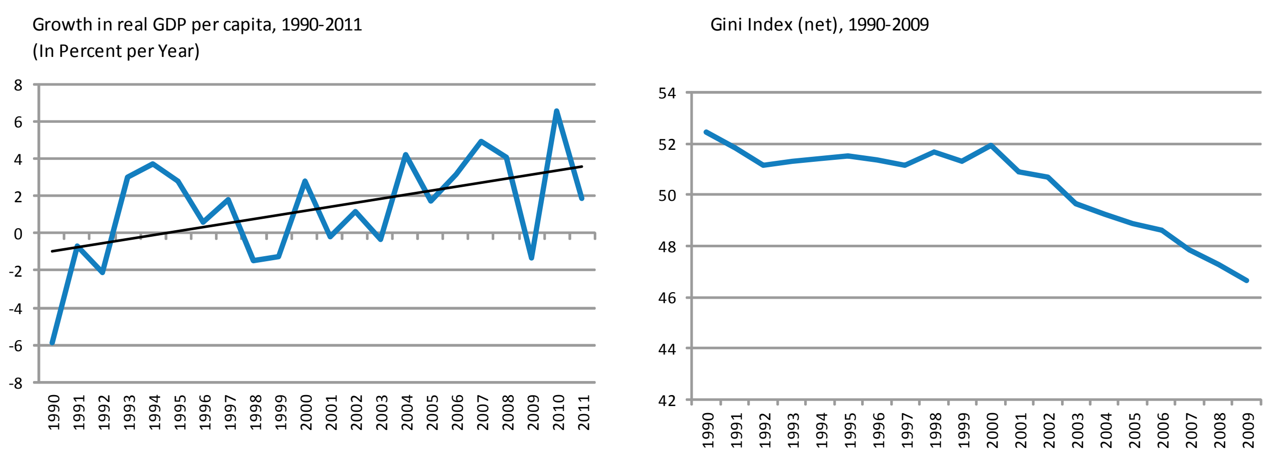
- Public and largely uniform provision of key services, notably health care and education, serving both as a instrument of redistribution in the short term and as a means of promoting greater long-term equality and efficiency.

- Direct income transfers and a progressive tax system to ensure that those better off help more than others to finance public expenditure.

**Brazil**

5. **In the past, Brazil has suffered long periods of low growth and very high inequality**. But starting in the early 1990s, and particularly during the past decade, improved macroeconomic stability, the commodity boom, and targeted social policies have contributed to high growth accompanied by substantial reduction in poverty and income inequality within a relatively short time frame. From 1990-2009, GDP growth per capita followed a strong upward trend, while inequality as measured by the Gini coefficient declined substantially.

**Brazil: Real GDP Growth and Gini Index**

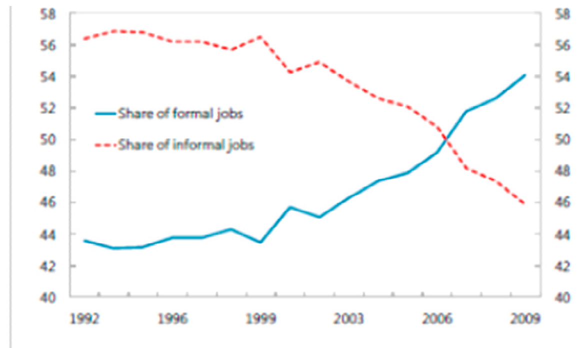



*Source: WEO and Standardized World Income Inequality Database (2011)*

6. **Reducing income inequality has been an important goal of the Brazilian government**. For this, the government used well-targeted and innovative social policies, among other policies. One popular scheme, called *Bolsa Familia*, has gained worldwide recognition as a tool for reducing (primarily rural) poverty at relatively low fiscal costs. This scheme features a direct cash transfer to poor families conditional on children's school attendance and their receiving basic health care. A study finds that one fifth of the decline in inequality during 1994-2005 can be credited to this program (Medeiros et al., 2006). Moreover, regulatory changes in favor of micro businesses have also contributed to promoting formalization in the labor market and reducing inequality. Formal jobs now account for more than half of all employment, an increase of 10 percentage points since 1990.

**Brazil: Measures of Informality, 1992-2009**

(In Percent of Jobs)



# Annex 7. The Legal Framework for the Jobs and Growth Agenda in the Fund

1. **Bilateral surveillance is part of the Fund's mandate under Article IV, Section 3**. This provision requires the Fund to oversee the compliance of each member with its obligations under Article IV, Section 1, which include obligations respecting the conduct of exchange rate policies and domestic economic and financial policies. Article IV, Section 1 requires each member to collaborate with the Fund and other members to assure orderly exchange arrangements and to promote a stable system of exchange rates and, in particular, to endeavor to direct economic and financial policies toward the objective of fostering orderly economic growth with reasonable price stability, with due regard to their circumstances.

2. **The legal framework for bilateral surveillance under Article IV is specified in greater detail in the Integrated Surveillance Decision (ISD)**.[1] That decision notes that the stable system of exchange rates that is the goal of Article IV is most effectively achieved when each member promotes its own domestic and balance of payment stability, the latter understood as a balance of payments position that does not and is not likely to give rise to disruptive exchange rate movements. The ISD also notes that, in the conduct of their domestic policies, members promote balance of payment stability by promoting their own domestic stability.[2] Therefore, the Fund, in its bilateral surveillance is required to assess whether a member's domestic policies are directed towards the promotion of domestic stability.

3. **Against this background, two questions arise**. First, in the context of bilateral surveillance, to what extent may the Fund examine questions related to economic growth in general? Second, to what extent may the Fund examine issues related to job creation and inclusive growth? Each of these questions is examined below.

4. **Surveillance may examine issues respecting the promotion of growth within the context of the promotion of domestic stability**. In particular, the obligation of members under Article IV, Section 1 (i) is to endeavor to promote orderly economic growth, and not economic growth per se. As performance relative to capacity is always a key ingredient of domestic stability and crucial for balance of payment stability, the ISD requires the Fund to always examine whether domestic policies are directed toward keeping the member's economy operating broadly at capacity; and in assessing whether members fulfill their obligation to seek to promote orderly economic growth, the Fund should pay due regard to members' circumstances. It is for this reason that the ISD recognizes that there are circumstances in which surveillance must pay particular attention to the need to promote higher rates of potential growth. Specifically, the decision requires the Fund to examine whether domestic policies are directed toward fostering a high rate of

[1] Decision No. 15203-(12/72), adopted July 18, 2012.

[2] The ISD also recognized that there may be circumstances where a member's domestic instability may give rise to systemic instability even in the absence of balance of payment instability.

potential growth but only in those cases where such high potential growth significantly influences prospects for domestic and, thereby, balance of payment stability.

5. **While the legal framework described above may suggest that issues related to job creation and income distribution may be examined in the context of surveillance in only limited circumstances, three important considerations should be kept in mind**.

- First, the promotion of domestic stability and orderly growth may be expected, in most cases, to create the environment in which jobs will be created and living conditions will improve.

- Second, Article IV and the ISD both seek to ensure that surveillance gives due attention to a member's domestic social policies, including those addressed at issues relating to job creation and income distribution. Thus, Article IV, Section 3 (b) provides that the principles that the Fund adopts for the guidance of members' exchange rate policies must respect the domestic social and political policies of members. Moreover, the ISD requires the Fund, in providing its policy advice to members, to identify ways in which member may achieve domestic and balance of payment stability while also attaining other objectives. To the extent that job creation and better income distribution are important objectives for a member, the Fund's advice on the promotion of domestic stability should, to the extent possible, be designed in a manner that helps the member achieve these other objectives.

- Third, even if important issues respecting job creation and inclusive growth fall outside of the context of surveillance, it is legally possible to discuss them in an Article IV consultation with the agreement of the relevant member. While the surveillance framework defines the scope of issues that members *are required to* discuss with the Fund under Article IV, it is also possible for members to *voluntarily agree* to discuss other issues with the Fund in an Article IV consultation. The Fund's policy advice on these issues would be —technical assistance under Article V, Section 2 (b) and not bilateral surveillance, but could be included in the member's Article IV consultation.

6. **The Fund provides financial assistance to its members so they may correct their balance of payments (BoP) problems without resorting to measures destructive of national or international prosperity**. The Articles of Agreement and decisions of the Executive Board implementing the Articles comprise the legal framework for the provision of Fund financial assistance. Financial assistance from the Fund's general resources account (GRA) and the Poverty Reduction and Growth Trust (PRGT) must be used to address a member's BoP problem. One of the purposes of the Fund, as set forth in Article I (v), requires that the Fund make GRA resources temporarily available to members "to correct maladjustments in their balance of payments without resorting to measures destructive of national or international prosperity" while Article V, Section 3 requires the Fund to "adopt policies … that will assist members to solve their balance of payments problems." A member requesting a purchase under the GRA must represent that it has a need "because of its balance of payments or its reserve position or development in its reserves." The PRGT Instrument provides that PRGT financial assistance is limited to low-income developing members to address certain types of balance of payments problems.

7. **The Fund's Guidelines on Conditionality set out the principles governing the design of programs supported by Fund financial assistance**. The Guidelines require that a member's program be directed primarily toward the macroeconomic goals of "solving the member's BoP problem and achieving medium-term external viability while fostering sustainable economic growth."[3] At the same time, the Guidelines provide that a program that meets these objectives may also be directed towards other objectives of importance to the member. Thus, the Guidelines recognize that, "in helping members to devise economic and financial programs, the Fund will pay due regard to the domestic social and political objectives, the economic priorities, and the circumstances of members." Therefore, the Fund may encourage and assist a member to pursue its own objectives related to inclusive growth and employment as part of its program if these objectives are consistent with the primary goals of helping the member correct its BoP problem and achieve external viability.

8. **The Guidelines also set out the principles governing the establishment of conditions on the use of Fund resources**. Under the Guidelines, program-related conditions are required generally to be either: (i) of critical importance for achieving the goals, or monitoring the implementation, of the member's program or (ii) necessary for the implementation of specific provisions of the Articles or policies adopted under them. Moreover, conditionality must reflect the member's circumstances.

9. **The extent to which the Fund may set conditions related to growth and job creation depends in part on the member's circumstances and the Fund facility under which the resources are provided**. Conditions on growth and job creation may be permitted, in particular, where they are viewed as necessary to achieve the primary goal of resolving the member's BoP difficulties or of achieving medium-term external viability while fostering sustainable economic growth. Moreover, the objectives of some Fund facilities explicitly place greater emphasis on growth and job creation than do others. For example, the Fund's Extended Fund Facility (EFF), though it does not include growth as an explicit goal, is intended, in part, to assist economies characterized by slow growth and an inherently weak BoP position which prevents pursuit of an active development policy.[4]

10. **Strong and durable poverty reduction and growth are important objectives of Fund financing under the PRGT**. The PRGT was designed to provide "loans on concessional terms to low-income developing members" to support programs and policies to correct BoP issues with the aim of achieving, maintaining, or restoring "stable and sustainable positions consistent with strong and durable poverty reduction and growth."[5] Growth and poverty reduction are thus explicit

[3] The Fund's Guidelines on Conditionality can be found at: http://www.imf.org/External/np/pdr/cond/2002/eng/guid/092302.htm.

[4] See the Factsheet on the EFF: http://www.imf.org/external/np/exr/facts/eff.htm.

[5] Annex to "*A New Architecture of Facilities for Low-Income Countries and Reform of the Fund's Concessional Financing Framework*," Decision No. 14593- (10/41), 6/01/10.

objectives of Fund financing under the PRGT, although Fund financing under the PRGT must also address members' BoP needs. The problems that PRGT-eligible countries frequently encounter, namely, poverty, high debt, and entrenched structural imbalances, tend to perpetuate these countries' BoP and macroeconomic instability. As such, unlike in GRA financing, a member's program supported under PRGT financing is required to emphasize growth, job creation, and poverty reduction.

# Annex 8. Role of Fiscal Policy in Supporting Growth

1. **Fiscal policy can help boost growth by contributing to macroeconomic stability over the short- and longer-term and improving the supply side capacity of the economy**. The role of fiscal policy as a tool for achieving macroeconomic stability has been the subject of extensive work for both advanced and developing economies (see for example IMF, 2010a, 2012n) and will not be examined here. In light of the large fiscal adjustment needs of the advanced economies, the discussion for these economies focuses on how to make fiscal consolidation supportive of growth over the longer term.

2. ***Expenditure reforms in advanced countries***: This entails the following:

- *Reforming public sector wages and social welfare benefits*. Countries where public sector wages are above those prevailing in the private sector should focus on containing these outlays. Reducing public sector employment and the wage bill can boost growth by putting downward pressure on the equilibrium wage in the private sector (Ardagna, 2004). Reforms of social welfare benefits that link the receipt of social benefits to work (in work-benefits) or participation in ALMPs can also increase incentives for labor force participation. Greater use of means-testing (which affects less than 10 percent of social benefit spending in the OECD) could contribute to fiscal consolidation while preserving benefits for those most in need (Adema and Ladaique, 2009).

- *Replacing generalized subsidies with more targeted income assistance*. This helps allocate resources to their most productive use while maintaining protection for the poor.

- *Containing increases in age-related spending.* This is necessary to avoid placing an even heavier burden on more productive spending. Health and pension spending consumes close to half of government non-interest spending. Over the next 20 years, pension spending is expected to rise by 1 percentage point of GDP, while health spending will rise by 3 percentage points (Clements et al., 2012a; and Clements, et al., 2012b). Reform of age-related spending will thus need to be a necessary ingredient in countries' fiscal consolidation plans. Pension reforms that help increase the number of years worked, such as raising the retirement age, will also have a salutary effect on growth (Karam et al., 2010) while helping contain projected spending increases. Reforms of age-related spending will need to be designed in a manner that maintains adequate levels of protection against poverty in old age and access to health care for low-income groups.

- *Preserving spending on public investment that addresses infrastructure bottlenecks*. The empirical literature suggests that fiscal adjustments focused on cuts in wages, subsidies, and transfers, rather than public investment, have been the least damaging for long-term growth (Hauptmeier et al., 2006; Kumar, et al., 2007; and Gemmell, et al., 2009).

3. ***Tax reforms in advanced countries***: Changes in the composition of tax revenues can help foster stronger economic growth. Income taxes and social contributions have the most adverse effects on growth, followed by consumption taxes, while property taxes have the lowest output impact (Arnold 2008). Improving the design of corporate tax systems can also boost investment and

growth by reducing the bias toward debt financing (Keen, Klemm, and Perry, 2010). In addition, targeted personal income tax relief can boost labor supply including for low-income workers and women. Eliminating distortive tax expenditures and reducing tax evasion should also be considered, as these help raise revenues in a more "growth-friendly" way than rate increases. Furthermore, there is scope for a greater use of corrective taxes. Energy taxation can correct prices that are below the levels that would fully capture externalities such as the effects of energy consumption on greenhouse gas emissions (IMF, 2013b). Increasing these taxes can increase welfare and help avoid the need to raise other taxes that could impinge on economic efficiency. Finally, appropriately-designed financial sector taxes may either offset distortions from the value-added tax (VAT) exemption of financial services (Financial Activities Tax) or internalize externalities from excessive risk taking (Financial Stability Contribution; see IMF, 2010b).

4. ***Expenditure reforms in developing countries:*** Reforms should focus on improving both the composition and efficiency of public spending.

- *Expenditure composition*: Spending should be reallocated away from unproductive activities toward those that can support the development of human and physical capital. Spending that should be examined for rationalization includes energy subsidies, which disproportionately benefit upper-income groups and retard growth (Arze del Granados, et al., 2012); the government wage bill, especially where public sector wages are high relative to the private sector and public sector employment is high; and social benefits where these disproportionately benefit upper-income groups.[1] The empirical literature suggests that reallocating this spending toward education, health, and public investment could have positive effects on growth (Baldacci et al., 2008; and Arslanalp et al., 2010).[2]

- *Improving efficiency*: Many countries could improve their delivery of essential public services to support growth by improving the efficiency of spending. In health, for example, at least 20-40 percent of spending is typically wasted (World Health Organization, 2010), and there is scope for substantial gains in health indicators at current levels of spending (Grigoli and Kapsoli, 2013). The link between public investment and growth can also be strengthened in many countries by improving project selection and implementation (Gupta et al., 2011).

5. **Tax reform in developing countries:** This is essential to finance higher levels of productive and pro-poor spending while maintaining a sustainable fiscal position. As in advanced economies, tax reform can boost growth by making the tax system more efficient.[3] The efficiency objective can

[1] Reducing the public sector wage bill and reallocating a larger share of public spending can help increase growth in low-income economies (Gupta et al., 2005).

[2] For a survey of the empirical literature on public spending and growth in developing economies, see Gemmell et al. (2013).

[3] The empirical literature on the effects of the level and composition of taxes on growth in developing economies is mixed. Much of it finds that the effects are insignificant (e.g., Adams and Bevan, 2005). More recently, Acosta-Ormaechea and Yoo (2012) find that increasing the share of income taxes (and reducing the share of consumption

(continued)

be met in principle with low and relatively uniform tax rates imposed on broad tax bases. For example, the VAT should have a single rate with exemptions limited to the extent possible. The base for corporate income tax should also be broadened by rationalizing tax incentives. Furthermore, greater emphasis could be placed on raising revenues from property taxes. Improving tax and customs administration could also help raise revenue without raising tax rates and improve the efficiency of the tax system.

taxes) in total tax revenues reduces growth in middle-income economies. The effect is insignificant, however, for low-income economies.

# Annex 9. Understanding Growth-Employment Linkages and Differentiating Between Cyclical and Structural Unemployment

1. **Analyzing growth-employment linkages has been the focus of a Fund staff project conducted over the last year**.[1] The project addresses a common concern about whether there is a 'disconnect' between the growth and employment in the sense that growth might translate into smaller gains in employment than in the past, or no gains at all. The project consists of three separate research papers, the first for 20 OECD countries (Ball, Leigh, and Loungani, 2013), the second for about 80 emerging and developing economies (Ball, Leigh, Furceri, and Loungani, 2013), and the third for a broad universe of 167 countries (Crivelli, Furceri, and Toujas-Bernate, 2012). The main findings are: (i) there is a strong and stable relation between growth and unemployment (employment) in most OECD countries; (ii) a robust relation—even though relatively weaker than in OECD economies, but increasing over time—is also observed for many emerging and developing economies;[2] (iii) there is some evidence that the employment-growth elasticity depends on policies, institutions, and structural characteristics (e.g., informality, sectoral distribution, and labor and product market institutions).

2. **The project also sheds light on debates over the extent to which current unemployment in a range of countries is cyclical or structural**, and it can provide guidance to country teams on how to differentiate between short-term (cyclical) and medium-term (structural) labor market developments. While projections of unemployment and other labor market indicators are key to indentifying labor market challenges and the appropriateness of growth and jobs strategies, they do not receive the same attention and scrutiny in staff reports and program documents as do other macroeconomic variables. Ideally, short- and medium-term desks' projections of unemployment and other labor market indicator could be regularly included in staff reports and possibly program documents and complement the set of tables and indicators typically reported. The table below presents a possible example on how to report key labor market projections.

[1] This issue of growth-employment linkages has also received mention in recent IMF surveillance work such as staff reports (e.g., IMF, 2012o, IMF 2012p) and in other documents such as WEOs (IMF 2010a, IMF 2012a) and REOs (IMF 2010c and IMF 2011d, IMF 2011e).

[2] The concept of unemployment is less meaningful in countries with a large informal sector. In these countries, people may move in and out of the informal sector depending on employment conditions. For some countries therefore, indicators of informal sector "employment" may be useful. Such information may be found through various household surveys (including the censuses of population that are carried out periodically in most countries).

**Table. Country X: Labor Market Projections**

| | | Projections 1/ | | | | | |
|---|---|---|---|---|---|---|---|
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 |
| Real GDP growth (%) | ... | ... | ... | ... | ... | ... | ... |
| Labor force (millions) 2/ | ... | ... | ... | ... | ... | ... | ... |
| Employment (millions) | ... | ... | ... | ... | ... | ... | ... |
| Unemployment rate (%) | ... | ... | ... | ... | ... | ... | ... |

Source: Country X authorities and Fund staff estimates.
1/ Projections based on employment-growth elasticity estimates (period x-2011). Source: Fund staff estimates (or Ball et al. 2013a, 2013b).

2/ Country X authorities; and Fund staff (ILO-Laborsta, ILO-KLIM) projections.

3. **To enable staff to fill the table, Fund staff (Abdih et al. 2012) have developed a labor market template that allows desks to analyze and project labor market indicators for any country with sufficient data coverage**. The template uses *Excel* to generate inputs in the form of user-customized employment and output data for Fund member countries. Specifically, the template produces the following:

- Estimates of employment-growth elasticities: these estimates are produced using a variety of econometric methods including individual country time-series regressions and panel data estimation methods. Estimation is performed by means of an easily executed program written using the Stata econometrics package.

- Medium-term labor market outcomes table: after the appropriate elasticity has been selected, a table of possible labor market outcomes is provided in Excel, with four different scenarios that the user may adjust as needed.

4. Projection charts: using the elasticity estimate, projected future growth, and other parameters previously customized by the user, two charts are provided in Excel: employment growth projections for the period of interest under a range of elasticities, and unemployment rate projections under baseline and reform assumptions.

# Annex 10. Labor Market Statistics on Inclusive Growth

*The implementation of a key recommendation of the paper—namely better diagnostics on the drivers of growth, job creation, and inclusion—depends critically on the availability of timely data of reasonable quality.*

1. **A basic requirement is timely employment and unemployment statistics preferably disaggregated by income level, gender, age, and educational achievements**. Primary data on these variables are drawn from the Labor Force Surveys (LFSs) undertaken by official national statistical offices (NSOs) but the ILO Library is a major source of online information on labor statistics and related information.[1] In particular, the ILO Department of Statistics' "short term indicators of the labor market"[2] includes monthly, quarterly, and annual data on population, economically-active (and inactive) population, employment, unemployment, working time, and earnings for about 90 countries. The data are disaggregated by sex and age group, but also by economic activity, geography, education, and duration (unemployment) as relevant/available. The data are also reasonably timely (e.g., through November 2012, as of early January 2013). The latest total employment series were from May 2012 or later for nearly 70 percent of the countries with nearly 90 percent from May 2011 or later. Users are cautioned that the statistics are based on national definitions and have not been adjusted or altered by the ILO. A major benefit to Fund economists of these data sites is that information on the scope of the statistics, their definitions and problems regarding consistency across countries, as well as historical data, are readily available.[3] The IMF's *International Financial Statistics* (*IFS*) database also contains data on employment, unemployment, and labor force.

2. **There are many pitfalls in the use of such statistics that require consultation of metadata on definitions and scope of the survey information**. For example, statistics on employment and the economically active population relate only to persons above a specified age, usually 15 years old and over, but there are exceptions. Some countries define the economically active population to effectively include child labor—persons 10 years old and over—a concept of economic inclusion that is normatively questionable.

---

[1] Annual data and metadata for over 200 countries are available on LABORSTA at: http://laborsta.ilo.org/data_topic_E.html. ILOSTAT was launched in December 2012 and provides recent data for over 100 indicators and 165 economies. This redesigned database featuring new subjects will gradually replace LABORSTA. Other databases with labor and poverty-related indicators include: the ILO's "Key Indicators of the Labour Market" (KILM) at: http://kilm.ilo.org/manuscript/default.asp#**;** European Labour Force Survey (EULFS) at: http://epp.eurostat.ec.europa.eu/portal/page/portal/microdata/lfs; OECD Employment and Labour Market Statistics at: http://www.oecd-ilibrary.org/employment/data/oecd-employment-and-labour-market-statistics_lfs-data-en; and development indicators from the World Bank at: http://data.worldbank.org/indicator and, particularly statistics on education at: http://data.worldbank.org/data-catalog/ed-stats.

[2] http://laborsta.ilo.org/sti/sti_E.html.

[3] For example, detailed information on the LFSs used and definitions for each country are available at: http://laborsta.ilo.org/applv8/data/SSM3_NEW/E/SSM3.html and http://laborsta.ilo.org/definition_E.html.

3. **The use of such statistics requires careful consultation of metadata on definitions and source and scope of the survey information**. For example, LFSs cover wage earners and salaried employees, including paid family workers, employers, own-account workers, members of producers' cooperatives, contributing family workers, and workers not classifiable. The data generally relate to employment during a specified brief period, either one week or one day. Usually, no distinction is made between persons employed full time and those working less than full time. Employment statistics from establishment surveys principally cover formal employment arrangements. They provide useful labor cost data as well as estimates of the number of workers on establishment payrolls for a specified payroll period or working day in this period. The establishments covered may be subject to a cut-off as to their size or a sample of all establishments. Official estimates provided by national authorities are usually based on combined information drawn from one or more of the other sources. Social insurance statistics only cover the working population protected by sickness, accident, or unemployment insurance schemes, or the like. The number of contributors or of contributions paid provides a measure of the number of insured persons in employment (unemployed persons being exempt from the obligation). Timely, high-frequency labor market statistics, broken down into detailed meaningful categories are important to the accuracy and analytical of labor market projections. Improvements to labor market economic analysis in the medium to long-term may include drawing the authority's attention to improving the quality of labor market data, as applicable.

4. **Aggregate employment figures take no account of changes in the quality of employment**. Job quality is determined principally by the level of compensation and the level of compensation by occupation and experience, among other factors. Thus, occupational breakdowns of jobs and compensation inform policy choices for raising living standards by encouraging growth in specific sectors. Education and occupational experience breakdowns of the labor force inform policy choices for raising living standards by favoring education and training in specific subject areas or at specific educational levels (primary, secondary, and tertiary).[4] The above employment-related data give little direct insight into employment dynamics as would be described by the numbers of job-openings, hires, quits, and layoffs. Such data could be important to the Fund's labor market surveillance needs but are not widely available even in rather advanced economies.[5]

[4] The World Bank EdStats Query holds around 2,500 internationally comparable education indicators for access, progression, completion, literacy, teachers, population, and expenditures. The indicators cover the education cycle from pre-primary to tertiary education. The query also holds learning outcome data from international learning assessments, equity data from household surveys, and projection data to 2050.

[5] A good example of the desired set of indicators on labor force dynamics that is a currently available is the U.S. Job Openings and Labor Turnover Survey (JOLTS) at http://www.bls.gov/jlt/.

5. **The main sources of information on economic inclusion can be found in the World Bank's World Development Indicators**.[6] There are many facets of economic inclusion other than employment, such as income inequality, access to shelter, health, education, and credit and while the World Bank's World Development Indicators is a primary site for such purpose-based statistics, there remain concerns about the adequacy of these measures.[7] The Fund collects the Financial Access Survey (FAS) (http://fas.imf.org), which provides annual geographic and demographic data on access to basic consumer financial services worldwide. The FAS database currently contains annual data for 187 jurisdictions, including all G20 economies, covering an eight-year period (2004-2011). Work is ongoing at the OECD to establish a framework linking micro and macroeconomic statistics on household income, consumption, and wealth, allowing assessment of the distributional features within macroeconomic aggregates.

[6] See for example: http://www.scepr.net/documents/publications/2008-12-Measuring-Poverty-and-Economic-Inclusion.pdf.

[7] See for example: http://www.scepr.net/documents/publications/2008-12-Measuring-Poverty-and-Economic-Inclusion.pdf.

# Annex 11. Summary of Views of External Experts

*This annex summarizes feedback received by the Working Group on Jobs and Growth through a consultation with external experts. The experts included representatives of multilateral institutions, think tanks, non-governmental organizations, labor unions, and academia. Most participants welcomed the paper as a step in the right direction to strengthen the Fund's understanding of issues related to job creation and inclusive growth. Many broadly supported its approach but others highlighted what they perceived as tensions with current Fund practices.*

The main points made were:

- Reforms that raise productivity growth are the way to link job strategies with growth strategies. Some participants said that more effectively tapping the global labor market can be an important source of growth for advanced economies. Others stressed the importance of focusing on education for employability. There was agreement that high productivity jobs are the key for growth with inclusion.

- The capture by a few of rents as an underlying cause of inequality applies not just to developing countries but also importantly to advanced countries, where the growth and deregulation of the financial sector and changes in taxation and labor market policies have contributed to the rising trend of income inequality. Inequality is driven not only by unemployment but also an increasing share of poorly paid jobs. Together with these, the decoupling of wage growth from productivity growth has contributed to the trend decline in the labor share of income. Some participants felt that we could consider raising taxation of high-income earners to finance growth and jobs strategies.

- Labor market institutions and policies: Some participants felt that wages should always be set at the level of living wages, and that minimum wages, even if coupled with negative income taxes or other transfers, may do little to contain rising inequality. More generally, policies should aim at ensuring that wages rise commensurately with productivity. Participants also noted that the desirable level of minimum wages depended to a large extent on country-specific factors and that it is very difficult to specify standard rules of thumb that can be universally applied. On the use of active labor market policies, some participants warned that the actual experience with such policies in developing countries is not uniformly favorable and that more work needs to be done to find interventions that work.

- Strengthening aggregate demand despite limited fiscal space: Some participants felt that the paper could be clearer about how to boost aggregate demand despite limited fiscal space in many advanced countries but also in developing countries. Some participants thought that the ratio of interest payments to GDP (rather than debt to GDP) was a better indicator of fiscal space and by that metric several governments had room to make long-term physical investment.

- Fund policy advice and Fund-supported programs: Some participants thought that Fund policy advice and conditions in Fund-supported programs so far stood in marked contrast to some of the paper's recommendations. The Fund had repeatedly opposed minimum wages and national-level bargaining, and had ignored adverse short-term effects of labor market reforms. Moreover, despite the rhetoric, few programs contain measures to protect the vulnerable from the adverse short-term effects of structural reforms. Also, traditionally the Fund's approach to supporting job creation had been to drive down wages. In contrast with the paper's recommendations that policymakers in advanced countries grappling with the aftermath of the Great Recession boost demand, a number of Fund-supported programs, particularly in Europe, were calling for unhelpful fiscal contraction in the short term.

- Gender issues: Several participants observed that empowerment of women was key, including to strengthen society's voice in identifying obstacles to growth, job creation, and inclusion. They noted that a strong public sector is actually the key to improving job and wage prospects for women and that this could be contradictory to the Fund's advice to shrink the role of the public sector in many countries.

# References

Abdih,Y., A. Behar, S. Cevik, R. Chami, L. Dougherty-Choux, D. Furceri, N. Janus, and P. Zimand, 2012, "A Template for Analyzing and Projecting Labor Market Indicators," IMF Technical Notes and Manuals (Washington: International Monetary Fund), September.

Acemoglu, D., 2011, "Thoughts on Inequality in Financial Crisis," presentation at the 2011 American Economic Association meetings, Colorado, United States, January.

Acemoglu, D., and F. Zilibotti, 1997, "Was Prometheus Unbound by Chance? Risk, Diversification, and Growth," *Journal of Political Economy*, Vol. 105 (August), Issue 4, pp. 709-751.

Acemoglu, D., and J. Robinson, 2012, *Why Nations Fail. The Origins of Power, Prosperity, and Poverty*, (New York: Crown Publishing).

Acosta-Ormaechea, S., and J. Yoo, 2012, "Tax Composition and Growth: A Broad Cross-Country Perspective," IMF Working Paper 12/257 (Washington: International Monetary Fund).

Adams, C., and D. Bevan, 2005, "Fiscal Deficits and Growth in Developing Countries," *Journal of Public Economics*, Vol. 89 (April), Issue 4, pp. 571–597.

Adema, W., and M. Ladaique, 2009, "How Expensive is the Welfare State? Gross and Net Indicators in the OECD Social Expenditure Database (SOCX)," OECD Social, Employment and Migration Working Paper 92 (Paris: Organisation for Economic Co-operation and Development).

Addison, T., and M. Niño-Zarazúa, 2012, What is Inclusive Growth, UNU-WIDER presentation at the Nordic-Baltic MDB meeting, Helsinki, Finland, January.

Aguirre, D., L. Hoteit, C. Rupp, and K. Sabbagh, 2012, *Empowering the Third Billion: Women and the World of Work in 2012* (Washington: Booz and Company).

Aiyar, S., R. Duval, D. Puy, Y. Yu, and L. Zhang, 2013 (forthcoming), "Growth Slowdowns and the Middle Income Trap," IMF Working Paper (Washington: International Monetary Fund).

Alesina, A., and R. Perotti, 1996, "Income distribution, political instability, and investment," *European Economic Review*, Vol. 40 (June), Issue 6, pp. 1203-1228.

______, and D. Rodrik, 1994, "Distributive Politics and Economic Growth," *The Quarterly Journal of Economics*, Vol. 109 (May), Issue 2, pp. 465-490.

Ardagna, S., 2004, "Fiscal Stabilizations: When Do They Work and Why," *European Economic Review*, Vol. 48 (October), Issue 5, pp. 1047-1074.

Arezki, R., R. Gylfason, and A. Sy, 2011, *Beyond the Curse: Policies to Harness the Power of Natural Resources* (Washington: International Monetary Fund).

Arezki, R., C. Pattillo, M. Quintyn, and M. Zhu, 2012, *Commodity Price Volatility and Inclusive Growth in Low-Income Countries* (Washington: International Monetary Fund).

Arnold, J., 2008, "Do Tax Structures Affect Aggregate Economic Growth? Empirical Evidence from a Panel of OECD Countries," OECD Working Paper No. 643 (Paris: Organisation for Economic Co-operation and Development).

Arslanalp, S., F. Bornhorst, S. Gupta, and E. Sze, 2010, "Public Capital and Growth," IMF Working Paper 10/175 (Washington: International Monetary Fund).

Arze del Granados, J., D. Coady, and R. Gillingham, 2012, "The Unequal Benefits of Fuel Subsidies: A Review of Evidence for Developing Countries," *World Development*, Vol. 40 (November), Issue 11, pp. 2234-2248.

African Development Bank, 2012, *Championing Inclusive Growth Across Africa*, (Abidjan: African Development Bank).

Asian Development Bank, 2012, *Country Diagnostic Studies* (Manila: Asian Development Bank)

Atkinson, A. B., and S. Morelli, 2011, "Economic Crises and Inequality," UNDP Human Development Research Paper 2011/06 (New York: United Nations Development Programme).

Aydin, B., 2011, "Ghana: Will It Be Gifted or Will It Be Cursed?" IMF Working Paper 11/104 (Washington: International Monetary Fund).

Baldacci, E., B. Clements, S. Gupta, and Q. Cui, 2008, "Social Spending, Human Capital, and Growth in Developing Countries," *World Development*, Vol. 36 (August), Issue 8, pp. 1317–1341.

Ball, L., D. Leigh, and P. Loungani, 2013, "Okun's Law: Fit at 50?" IMF Working Paper 13/10 (Washington: International Monetary Fund).

Ball, L., D. Leigh, D. Furceri, and P. Loungani, 2013 (forthcoming), "Does One Law Fit All? Okun's Law Outside the OECD," IMF Working Paper (Washington: International Monetary Fund).

Banerjee, A., 2004, Inequality and Investment (Cambridge: MIT Press).

______, and E. Duflo, 2003, "Inequality and Growth: What Can the Data Say?" *Journal of Economic Growth*, Vol. 8 (June), Issue 3, pp. 267-99.

Barkbu, B., J. Rahman, and R. Valdés, 2012, "Fostering Growth in Europe Now," IMF Staff Discussion Note 12/07 (Washington: International Monetary Fund).

Barsh, J., and L. Yee, 2012, "Unlocking the Full Potential of Women at Work," *The Wall Street Journal* (Washington: McKinsey and Company).

Bastagli, F., D. Coady, and S. Gupta, 2012, "Income Inequality and Fiscal Policy," IMF Staff Discussion Note 12/08 (Washington: International Monetary Fund).

Bayraktar, N., and B. Moreno-Dodson, 2010, "How Can Public Spending Help You Grow? An Empirical Analysis for Developing Countries," The World Bank Policy Research Working Paper 5367 (Washington: The World Bank).

Bean, C., and C. Pissarides, 1993, "Unemployment, consumption and growth," *European Economic Review*, Vol. 37 (May), Issue 4, pp. 837-854.

Becker. G., 1985, "Public Policies, Pressure Groups, and Dead Weight Costs," *Journal of Public Economics*, Vol. 28 (December), Issue 3, pp. 329-347.

Bell, D., and D. Blanchflower, 2011, "Youth Unemployment in Europe and the United States," IZA Discussion Paper 5673 (Bonn: Institute for the Study of Labor).

Berg, A., and J. Ostry, 2011, "Inequality and Unsustainable Growth: Two Sides of the Same Coin?" Staff Discussion Note 11/08 (Washington: International Monetary Fund).

Bernal-Verdugo, L., D. Furceri, and D. Guillaume, 2012, "Crises, Labor Market Policy, and Unemployment," IMF Working Paper 12/65 (Washington: International Monetary Fund).

Betcherman, G., 2013, "Labor Market Institutions: A Review of Literature," background paper for the *World Development Report 2013* (Washington: The World Bank).

Blanchard, O., F. Jaumotte, and P. Loungani, forthcoming, "Labor Market Policies in Advanced Countries During the Great Recession," Staff Discussion Note (Washington: International Monetary Fund).

Bordo, M., and C. Meissner, 2012, "Does Inequality Lead to a Financial Crisis?" *Journal of International Money and Finance*, Vol. 31 (December), Issue 8, pp. 2147-2161.

Bose, N., E. Haque, and D. Osborn, 2007, "Public Expenditure and Economic Growth: A Disaggregated Analysis for Developing Countries," *The Manchester School,* Vol. 75 (August), Issue 5, pp. 533–556.

Boughton, J., 2000, *The IMF and the Silent Revolution: Global Finance and Development in the 1980s* (Washington: International Monetary Fund).

Bourguignon, F., F. Ferreira, and M. Walton, 2007, "Equity, Efficiency and Inequality Traps: A Research Agenda," *Journal of Economic Inequality*, Vol. 5, Issue 2, pp. 235–256.

Brooks, R., and R. Tao, 2003, "China's Labor Market Performance and Challenges," IMF Working Paper WP/03/210 (Washington: International Monetary Fund).

Brunori, P., F. Ferreira, and V. Peragine, 2013, "Inequality of Opportunity, Income Inequality and Economic Mobility," The World Bank Policy Research Working Paper 6304 (Washington: The World Bank).

Campbell, D. and I. Ahmed, 2012: "The Labour Market in Developing Countries," presented at the 7th IZA/World Bank Conference, New Delhi, India, November.

Committee for Economic Development, 2012, *Fulfilling the Promise: How More Women on Corporate Boards Would Make America and American Companies More Competitive,* (Washington: Committee for Economic Development).

Cho, Y., D. Margolis, D. Newhouse, and D. Robalino, 2012, "Labor Markets in Low and Middle Income Countries: Trends and Implications for Social Protection and Labor Policies," The World Bank Social Protection and Labor Discussion Paper 1207 (Washington: The World Bank).

Chu, K.Y., and S. Gupta, 1998, *Social Safety Nets: Issues and Experiences* (Washington: International Monetary Fund).

Clements, B., D. Coady, F. Eich, S. Gupta, A. Kangur, B. Shang, and M. Soto, 2012a, *The Challenge of Public Pension Reform in Advanced and Emerging Economies*, IMF Occasional Paper No. 275 (Washington: International Monetary Fund).

Clements, B., D. Coady, and S. Gupta, 2012b, eds., *The Economics of Public Health Care Reform in Advanced and Emerging Economies* (Washington: International Monetary Fund).

Clements, B., S. Gupta, and M. Nozaki, 2013, "What Happens to Social Spending in IMF-Supported Programs," *Applied Economics*, Vol. 45, No. 28, pp. 4022-4033.

Corak, M., 2012, *Inequality from Generation to Generation: The United States in Comparison* (Ottawa: University of Ottawa).

Crivelli, E., D. Furceri, and J. Toujas-Bernate, 2012, "Can Policies Affect Employment Intensity of Growth? A Cross-Country Analysis," IMF Working Paper 12/218 (Washington: International Monetary Fund).

Dabla-Norris, E., 2012, "Inclusive Growth and the IMF's Agenda," Mimeo.

Dezso, C., and D. Ross, 2011, "Does Female Representation in Top Management Improve Firm Performance? A Panel Data Investigation," RHS Research Paper 06-104 (College Park: Robert H. Smith School of Business).

Duflo, E., 2000, "Grandmothers and Granddaughters: Old Age Pension and Intra-Household Allocation in South Africa," NBER Working Paper 8061 (Cambridge: The National Bureau of Economic Research).

______, 2011, "Women's Empowerment and Economic Development," NBER Working Paper 17702 (Cambridge: The National Bureau of Economic Research).

De Mooij, R., 2011, "Tax Biases to Debt Finance: Assessing the Problem, Finding Solutions," IMF Staff Discussion Note 11/11 (Washington: International Monetary Fund).

______, and M. Keen, 2012, "Fiscal Devaluation and Fiscal Consolidation: The VAT in Troubled Times," IMF Working Paper 12/85 (Washington: International Monetary Fund).

European Commission, 2010, *Europe 2020: A Strategy for Smart, Sustainable and Inclusive Growth* (Brussels: European Commission).

Evangelista, I., and C. Filho, 2008, "Household Income as a Determinant of Child Labor and School Enrollment in Brazil: Evidence from a Social Security Reform," IMF Working Paper 08/241 (Washington: International Monetary Fund).

Forbes, K., 2000, "A Reassessment of the Relationship between Inequality and Growth," *American Economic Review*, Vol. 90 (September), Issue 4, pp. 869-887.

Friedman, M., 1955, "The Role of Government Education," in *Economics and the Public Interest*, ed. by R. Solo (New Jersey: Rutgers University Press).

Gardner, E., 2003, *Creating Employment in the Middle East and North Africa* (Washington: International Monetary Fund).

Gemmell, N., F. Misch, and B. Moreno-Dodson, 2013, "Public Spending and Long-Run Growth in Practice: Concepts, Tools, and Evidence," in *Is Fiscal Policy the Answer? A Developing Country Perspective*, ed. by B. Moreno-Dodson (Washington: The World Bank).

Gemmell, N., R. Kneller, and I. Sanz, 2009, "The Composition of Government Expenditure and Economic Growth: Some Evidence from OECD Countries," in *The Quality of Public Finances and Economic Growth*, European Commission Occasional Paper No. 45 (Brussels: European Commission).

Grigoli, F., and J. Kapsoli, 2013 (forthcoming), "Waste Not Want Not: The Efficiency of Health Spending in Developing Countries," IMF Working Paper (Washington: International Monetary Fund).

Commission on Growth and Development, 2008, *The Growth Report: Strategies for Sustained Growth and Inclusive Development* (Washington: The World Bank).

Gupta, S., B. Clements, E. Baldacci, and C. Mulas-Granados, 2005, "Fiscal Policy, Expenditure Composition, and Growth in Low-Income Countries," *Journal of International Money and Finance*, Vol. 23 (April), Issue 3, pp. 441-463.

______, A. Kangur, C. Papageorgiou, and A. Wane, 2011, "Efficiency-Adjusted Public Capital and Growth," IMF Working Paper 11/217 (Washington: International Monetary Fund).

______, G. Schwartz, S. Tareq, R. Allen, I. Adenauer, K. Fletcher, and D. Last, 2007, "Fiscal Management of Scaled-Up Aid," IMF Working Paper WP/07/222 (Washington: International Monetary Fund).

Hagen, K., 2003, "Policy Dialogue between the International Labour Organization and the International Financial Institutions: The Search for Convergence," FES Occasional Paper 9 (Washington: Friedrich Ebert Stiftung).

Hauptmeier, S., M. Heipertz, and L. Schuknecht, 2006, "Expenditure Reform in Industrialized Countries: A Case Study Approach," ECB Working Paper 634 (Brussels: European Central Bank).

Hausmann, R., D. Rodrik, and A. Velasco, 2006, "Getting the Diagnosis Right," *Finance & Development,* Vol. 43 (March), Issue 1.

Hoeller P., I. Joumard, M. Pisu, and D. Bloch, 2012, "Less Income Inequality and More Growth—Are They Compatible? Part 1. Mapping Income Inequality Across the OECD" OECD Working Paper 924 (Paris: Organisation for Economic Co-operation and Development).

Imbs, J., and R. Wacziarg, 2003, "Stages of Diversification," *American Economic Review*, Vol. 93 (March), Issue 1, pp. 63-86.

International Finance Corporation, 2010, *Scaling-Up SME Access to Financial Services in the Developing World* (Washington: International Finance Corporation).

______, 2013, *IFC Jobs Study: Accessing Private Sector Contributions to Job Creation and Poverty Reduction* (Washington: International Finance Corporation).

International Institute for Labour Studies, 2012, *World of Work Report: Better Jobs for a Better Economy* (Geneva: International Labour Organization).

International Labour Organization, IMF, OECD, and World Bank, 2012, *Boosting Jobs and Living Standards in G-20 Countries* (Geneva: International Labour Organization).

International Monetary Fund, 1995, "Social Dimensions of the IMF's Policy Dialogue," IMF Pamphlet No. 47 (Washington: International Monetary Fund).

______, 2007, "The Globalization of Labor," in *World Economic Outlook, April 2007: Spillovers and Cycles in the Global Economy*, World Economic and Financial Surveys (Washington: International Monetary Fund).

______, 2010a, *World Economic Outlook, October 2010: Recovery, Risk, and Rebalancing*, World Economic and financial Surveys (Washington: International Monetary Fund).

______, 2010b, *A Fair and Substantial Contribution by the Financial Sector: Final Report for the G20* (Washington: International Monetary Fund).

______, 2010c, *Regional Economic Outlook, October 2010: Middle East and Central Asia Department*, World Economic and Financial Surveys (Washington: International Monetary Fund).

______, 2011a, *Regional Economic Outlook, October 2011: Sub-Saharan Africa: Sustaining the Expansion*, World Economic and Financial Surveys (Washington: International Monetary Fund).

______, 2011b, *New Growth Drivers for Low-Income Countries: The Role of BRICs* (Washington: International Monetary Fund).

______, 2011c, *Macroeconomic and Operational Challenges in Countries in Fragile Situations* (Washington: International Monetary Fund).

______, 2011d, *Regional Economic Outlook, April 2011: Middle East and Central Asia Department*, World Economic and Financial Surveys (Washington: International Monetary Fund).

______, 2011e, *Regional Economic Outlook, October 2011: Western Hemisphere–Shifting Winds, New Policy Challenges*, World Economic and Financial Surveys (Washington: International Monetary Fund).

______, 2012a, *World Economic Outlook, October 2012: Coping with High Debt and Sluggish Growth*, World Economic and Financial Surveys (Washington: International Monetary Fund).

______, 2012b, *Fiscal Policy and Employment in Advanced and Emerging Economies* (Washington: International Monetary Fund).

______, 2012c, *2011 Review of Conditionality—Overview Paper* (Washington: International Monetary Fund).

______, 2012d, *Review of Facilities for Low-Income Countries—Supplement 1* (Washington: International Monetary Fund),

______, 2012e, *The Liberalization and Management of Capital Flows - An Institutional View* (Washington: International Monetary Fund).

______, 2012f, *Regional Economic Outlook, October 2012 Update: Asia and Pacific Department*, World Economic and Financial Surveys (Washington: International Monetary Fund).

______, 2012g, *Botswana Article IV: Selected Issues Paper*, IMF Staff Country Report No. 12/235 (Washington: International Monetary Fund).

______, 2012h, *Regional Economic Outlook, October 2012: Sub-Saharan Africa– Maintaining Growth in an Uncertain World*, World Economic and Financial Surveys (Washington: International Monetary Fund).

______, 2012i, *Macroeconomic Policy Frameworks for Resource-Rich Developing Countries* (Washington: International Monetary Fund).

______,2012j, *Italy 2012 Article IV Consultation*, IMF Staff Country Report No. 12/167 (Washington: International Monetary Fund).

______, 2012k, *Japan 2012 Article IV Consultation*, IMF Staff Country Report No. 12/208 (Washington: International Monetary Fund).

______, 2012l, *Saudi Arabia: Selected Issues*, IMF Staff Country Report No. 12/272 (Washington: International Monetary Fund),

______, 2012m, *Enhancing Financial Sector Surveillance in Low-Income Countries: Financial Deepening and Macrostability* (Washington: International Monetary Fund).

______, 2012n, *Fiscal Monitor April 2012: Balancing Fiscal Policy Risks*, World Economic and Financial Series (Washington: International Monetary Fund).

______, 2012o, *Algeria: Selected Issues Paper*, IMF Staff Country Report No. 12/22 (Washington: International Monetary Fund).

______, 2012p, *Spain 2012 Article IV Consultation*, IMF Staff Country Report No. 12/202 (Washington: International Monetary Fund).

______, 2013a, *Macroeconomic Issues in Small States*, SM13/43, 2/20/2013 (Washington: International Monetary Fund).

______, 2013b, *Energy Subsidy Reform—Lessons and Implications* (forthcoming, Washington: International Monetary Fund).

Jahan, S., and B. McDonald, 2011, "A Bigger Slice of a Growing Pie," *Finance & Development*, Vol. 48 (September), Issue 3, pp. 16-19.

Jaumotte, F., 2003, "Labour Force Participation of Women: Empirical Evidence on the Role of Policy and Other Determinants in OECD Countries," OECD Economic Studies No. 37 (Paris: Organisation for Economic Co-operation and Development).

______, S. Lall, and C. Papageorgiou, 2012, "Rising Income Inequality: Technology, or Trade and Financial Globalization," IMF Working Paper WP/08/185 (Washington: International Monetary Fund).

Johnson, S., Ostry, J., D., and Subramanian, D., 2007, "The Prospects for Sustained Growth in Africa: Benchmarking the Constraints," IMF Working Paper 07/52 (Washington: International Monetary Fund).

Kaldor, N., 1955, "Alternative Theories of Distribution," *The Review of Economic Studies*, Vol. 23, Issue 2, pp. 83-100.

Karam, P., D. Muir, J. Pereira, and A. Tuladhar, 2010, "Macroeconomic Effects of Public Pension Reforms," IMF Working Paper WP/10/297 (Washington: International Monetary Fund).

Keen, M., A. Klemm, and V. Perry, 2010, "Tax and the Crisis," *Fiscal Studies* Vol. 31 (March), Issue 1, pp. 43–79.

Keynes, J. M., 1937, "Alternative Theories of the Rate of Interest," *The Economic Journal*, Vol. 47 (June), Issue 186, pp. 241-252.

Khan, M., and P. Montiel, 1989, "Growth-Oriented Adjustment Programs A Conceptual Framework," *Staff Papers*, International Monetary Fund, Vol. 36 (June), Issue 2, pp. 279-306.

Kochhar, R., 2011, *In Two Years of Economic Recovery, Women Lot Jobs, Men Found Them* (Washington: Pew Research Center).

Kose, A., P. Loungani, and M. Terrones, 2013 (forthcoming), "Global Recessions and Global Recoveries," IMF Working Paper (Washington: International Monetary Fund)

Kumar, M., D. Leigh, and A. Plekhanov, 2007, "Fiscal Adjustments: Determinants and Macroeconomic Consequences," IMF Working Paper 07/196 (Washington: International Monetary Fund).

Kuznets, S., 1955, "Economic Growth and Income Inequality," *The American Economic Review*, Vol. 45 (March), Issue 1, pp. 1-28.

Laframboise, N., and T. Trumbic, 2003, "The Effects of Fiscal Policies on the Economic Development of Women in the Middle East and North Africa," IMF Working Paper 03/244 (Washington: International Monetary Fund).

Larsen, F., 1997, "The United States as a Job Creation Machine: an Example for Germany?" address at a conference by the Christian Social Union, Bavaria, Germany, October.

Limi, A., 2006, "Did Botswana Escape from the Resource Curse?," IMF Working Paper WP/06/138 (Washington: International Monetary Fund).

Lin, J., 2012, *The Quest for Prosperity: How Developing Economies Can Take Off* (Princeton: Princeton University Press).

Lledo, V., 2008, "Strengthening Mozambique's Business Environment: Diagnostics, Strategies, and Outcomes," in *Post-Stabilization Economics in Sub-Saharan Africa*, ed. by J. Clement and S. Peiris (Washington: International Monetary Fund).

Matsui, K., 2010, *Womenomics 3.0: The Time is Now*, Goldman Sachs Global Economics, Commodities and Strategy Research (Tokyo: The Goldman Sachs Group, Inc.)

McMillan, M., and D. Rodrik, 2011, "Globalization, Structural Change and Productivity Growth," NBER Working Paper 17143 (Cambridge: National Bureau of Economic Research).

Medeiros, M., R. Osorio, F. Soares, and S. Soares, 2006, "Cash Transfer Programmes in Brazil: Impacts on Inequality and Poverty," International Poverty Centre Working Paper No. 21 (Brazil: United Nations Development Programme).

Montiel, P., and L. Serven, 2009, "Real Exchange Rate, Saving, and Growth: Is There a Link?" The World Bank Policy Research Working Paper 4636 (Washington: The World Bank).

Moore, D., and A. Vamvakidis, 2007, "Economic Growth in Croatia: Potential and Constraints," IMF Working Paper 07/198 (Washington: International Monetary Fund).

Morsy, H., 2012, "Scarred Generation," *Finance & Development,* Vol. 49 (March), Issue 1, pp. 15-17.

OECD, 1994, *The OECD Jobs Study: Facts, Analysis, Strategies* (Paris: Organisation for Economic Co-operation and Development).

______, 2006, "Boosting Jobs and Incomes," *OECD Employment Outlook* (Paris: Organisation for Economic Co-operation and Development).

______, 2012a, *Economic Policy Reforms 2012: Going for Growth* (Paris: Organisation for Economic Co-operation and Development).

______, 2012b, *Closing the Gender Gap: Act Now* (Paris: Organisation for Economic Co-operation and Development).

Papageorgiou, C., and N. Spatafora, 2012, "Economic Diversification in LICs: Stylized Facts and Macroeconomic Implications," IMF Staff Discussion Note 12/13 (Washington: International Monetary Fund).

Rajan, R., 2010, *Fault Lines: How Hidden Fractures Still Threaten the World Economy* (Princeton: Princeton University Press).

______, and A. Subramanian, 2011 "Aid, Dutch Disease, and Manufacturing Growth," *Journal of Development Economics,* Vol. 94 (January), Issue 1, pp. 106-118.

Ravallion, M., 2004, "Pro-Poor Growth: A Primer," The World Bank Policy Research Working Paper 3242 (Washington: The World Bank).

Reich, R., 2010, *After-Shock: The Next Economy and America's Future* (New York: Knopf).

Rodrik, D., 1999, "Where Did All the Growth Go? External Shocks, Social Conflict, and Growth Collapses," *Journal of Economic Growth*, Vol. 4 (December), Issue 4, pp. 385-412.

______, 2008, "The Real Exchange Rate and Economic Growth," *Brookings Papers on Economic Activity*, Vol. 39, Issue 2, pp. 365–4439.

______, 2011, "Unconditional Convergence," NBER Working Paper 17546 (Cambridge: National Bureau of Economic Research).

Rungcharoenkitkul, P., 2012, "Modeling with Limited Data: Estimating Potential Growth in Cambodia," IMF Working Paper 12/96 (Washington: International Monetary Fund).

Sala-i-Martin, X., 2006, "The World Distribution of Income: Falling Poverty and … Convergence, Period." *The Quarterly Journal of Economics*, Vol. 121 (May), Issue 2, pp. 351-397.

______, and A. Subramanian, 2003, "Addressing the Natural Resource Curse: An Illustration from Nigeria," IMF Working Paper WP/03/139 (Washington: International Monetary Fund).

Solt, F., 2009, "Standardizing the World Income Inequality Database." *Social Science Quarterly*, Vol. 90 (June), Issue 2, pp. 231-242.

Stavropoulou, M., and N. Jones, 2013, *Off the Balance Sheet: The Impact of the Economic Crisis on Girls and Young Women–A Review of the Evidence* (United Kingdom: Plan).

Steinberg, C., and M. Nakane, 2012, "Can Women Save Japan?" IMF Working Paper 12/48 (Washington: International Monetary Fund).

Stotsky, J., 2006, "Gender and Its Relevance to Macroeconomic Policy: A Survey," IMF Working Paper 06/233 (Washington: International Monetary Fund).

Tanzi V., K.Y. Chu, and S. Gupta, 1999, *Economic Policy and Equity* (Washington: International Monetary Fund)

______, and K.Y. Chu, 1998, *Income Distribution and High-Quality Growth* (Cambridge: MIT Press)

Tsani, S., L. Paroussos, C. Fragiadakis, I. Charalambidis, and P. Capros, 2012, "Female Labour Force Participation and Economic Development in Southern Mediterranean Countries: What Scenarios for 2030?" MEDPRO Technical Report No. 19 (Brussels: Mediterranean Prospects)

Tsounta, E., 2006, "Why Are Women Working So Much More in Canada? An International Perspective," IMF Working Paper 06/92 (Washington: International Monetary Fund).

United Nations, 2013, *World Economic Situation and Prospects 2013* (New York: United Nations).

United Nations Entity for Gender Equality and the Empowerment of Women, and ILO, 2012, "Decent Work and Women's Economic Empowerment: Good Policy and Practice," *Policy Brief* (New York: UN Women)

The World Bank, 2011, *World Development Report 2012: Gender Equality and Development* (Washington: The World Bank).

______, 2012, *World Development Report 2013: Jobs* (Washington: The World Bank)

World Health Organization, 2000, *The World Health Report 2010–Health Systems: Improving Performance* (Geneva: World Health Organization).